

Summit on Market Demand Emphasizes Importance of Underwriting and Market Analysis

By Thom Amdur, National Council of Affordable Housing Market Analysts

With the flow of equity and debt ground to a near halt, the watchwords for low-income housing tax credit (LIHTC) developers and professionals in 2009 will be “accurate and conservative underwriting.” Despite LIHTC projects having the lowest foreclosures rates of any commercial real estate asset class, an influx of new investing and lending in multifamily affordable rentals is unlikely in the immediate future. Deals that do get funded will face great scrutiny of an area many developers too often leave as an after thought—the market study.

Residential real estate market analysis has come a long way since the days of the “back-of-the-napkin” market study. Since its formation in 2001, the National Council of Affordable Housing Market Analysts (NCAHMA), a national trade group of real estate market study providers, has worked to develop research and best practices to improve the quality and usability of market research. NCAHMA recently convened its 2008 Multifamily Market Demand Summit in Chicago to explore how changing market dynamics resulting from the sub-prime lending fiasco and credit crunch are impacting the underwriting of LIHTC projects. This article will explore why developers now more than ever need to use a qualified market analyst and the key market issues that are taking precedence in today’s financial environment.

Do I Really Need a Market Analyst? Can’t My Appraiser Take Care of This?

Many market analysts are appraisers but not all appraisers are market analysts. Market studies and appraisals are fundamentally different types of research and require largely different skill sets and methodologies. A market study is a comprehensive review of a housing market in a defined market area. Project specific market studies are

often used by developers, syndicators, and government entities to determine the appropriateness of a proposed development. A market study will measure demand for a specific multifamily project and calculate rents levels that are appropriate and achievable in that particular geographic market.

In contrast, an appraisal is an estimate of current market value, or to put it another way, the price at which a willing seller would likely sell and a willing buyer would buy. Appraisal methodology focuses on entirely different factors like replacement cost, earning power and sales of comparable properties.

State housing finance agencies and syndicators alike pointed out in respective sessions at NCAHMA’s 2008 Multifamily Demand Summit that they still receive too many market studies that are incomplete, poor in quality or misleading. This can result in good deals not being funded, or worse, poor deals being funded. NCAHMA has developed a member designation to address these concerns. As a result, there is a growing trend within both the investment community and the housing finance agencies to require or give incentives to hire NCAHMA-qualified market analysts. Whether or not an NCAHMA analyst is used, developers and state agencies alike need to be very careful in selecting a professional to ensure experience and the right skill set, or risk an incomplete or misleading conclusion.

What Are The Hot Button Market Issues That Investors Really Care About?

Once a market analyst has been hired, there are key “hot button” market issues that need to be considered. The Chicago summit featured a candid session with represen-

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tatives from Ernst & Young LLP, MMA Financial, Red Stone Equity Partners and RBC Capital Markets that explored evolving investor concerns on market issues. In today's market, LIHTC investors have their pick of the litter and are examining market issues much more carefully when choosing deals for equity investment. The investors that are still active today are highly focused on real estate performance issues and the long-term value of the asset. Some key issues that will make or break the ability to get tax credits include:

1. Local conditions and immediate adjacent land use. Investors are looking very closely at anything that could impede (e.g. train tracks) or encourage (e.g. transportation links) development of the property.
2. Neighborhood trends and perceptions. The upkeep and maintenance of neighboring properties (e.g. rental, homeownership, commercial) can play paramount importance. With so many investment opportunities, investors will not take a risk on developments in neighborhoods that are perceived to be in decline.
3. Operating expenses. This remains one of the biggest variables in a property's long-term performance. Investors want to see realistic operating projections and will compare the project to the rest of a portfolio and the local comps.
4. Rent growth. Investors want to see conservative rent growth estimates. Recent changes in the way HUD calculates area median income (AMI) and the economic downturn can result in different rent growth trends than those of the past.
5. Utility expenses. Rising energy costs are likely to remain an issue for a long time to come. If an area has had big year-to-year increases in utility costs, investors will want to see how this compares to the historical trends of the growth of PHA utility allowances.
6. Drive times. Investors want to see reasonable drive times to major employment centers. They also want to see an analysis of comparable properties located between your property and these employment centers. In today's energy environment, investors see long drive times coupled with high

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Journal of Tax Credit Housing Information

Novogradac & Company LLP
246 First Street, 5th Floor
San Francisco, CA 94105
E-mail: cpas@novoco.com

Address all correspondence and editorial submissions to:
Jane Bowar Zastrow
Telephone: 415.356.8034

Address inquiries regarding advertising opportunities to:
Junhee Byun
Telephone: 415.356.8037

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- gasoline prices as a big liability.
7. Non-multifamily comparable properties. In many markets, single-family homeownership opportunities may compete with higher income tax credit projects. In other markets, single-family foreclosures have been converted to competitive rentals. Often, mobile homes may also compete directly with an LIHTC development. Investors want to see current and local analyses of these comps along with the more traditional multifamily comparable properties (i.e. tax credit and market-rate).
 8. Aggressive rent adjustments. Be careful about charging increased rents for “larger” units—if you are charging a premium for size, be sure units are significantly larger than any competitors’. Likewise, not all amenities create added value. For example, a small business center with a few computers generally won’t add much if any perceived value, whereas a no-fee garage parking spot or secure property entry may be a big plus.
 9. Rent advantage. Properties should have a significant projected rent advantage over local conventional rents. Investors want to see achievable LIHTC rents notably lower than derived market rents.

Conclusions

A good third-party market analyst will do more than give a deal a “thumbs up” or “thumbs down.” The analyst’s knowledge and expertise can help tailor a deal to determine the right unit mix, rent levels and amenities and even help with site selection.

NCAHMA has developed widely adopted standards for market studies for affordable housing, as well as best practices, ethical standards and white papers to ensure the quality of market studies. These standards have been adopted or incorporated by a range of industry organizations including the Affordable Housing Investment Council, a national organization comprised of corporations engaged in the investment of funds for affordable housing; the National Housing & Rehabilitation Association, a national professional association of tax credit developers and professionals; and 20 state housing finance agencies.

NCAHMA members are encouraged to undergo regular peer review and satisfy annual continuing education requirements. Membership information, best practices and conference information along with a directory of peer reviewed market analysts is all available online at www.housingonline.com. Conference recordings and supporting material from the 2008 Market Demand Summit are also available for sale at NCAHMA’s web site. Questions can be directed to Thom Amdur at tamdur@housingonline.com or 202-939-1753. ❖

Thom Amdur is the associate director for the National Council of Affordable Housing Market Analysts (NCAHMA). NCAHMA works to bring accountability and consistency to market studies for affordable housing properties and other residential real estate. NCAHMA is an independent Council of the National Housing & Rehabilitation Association. Additional information can be found on its web site www.housingonline.com.