Novogradac
Journal of Tax Credits
News, Analysis and Commentary On Affordable Housing, Community Development and Renewable Energy Tax Credits
November 2011, Volume II, Issue XI
Published by Novogradac & Company LLP

Despite High Pricing, Experts Say LIHTC Market is Stronger than Ever

By Jennifer Hill, Staff Writer, Novogradac & Company LLP

As low-income housing tax credit (LIHTC) prices have continued to trend steadily upward since last year's rebound, the industry is focused on sustaining the market's momentum. But, for a variety of reasons, the long-awaited higher prices may be too much of a good thing, according to panelists at Novogradac & Company LLP's Affordable Housing Tax Credit Conference in San Francisco, Calif.

The annual panel has been named the "State of the Equity Market" in prior years, but in a nod to how far the market has come since 2009, September's session was called "Resurgence of the LIHTC Market." In the hotter markets like New York and California, credit prices trended to more than $1.01 last month, the highest since May 2007. "Remember when we said they would never get there again? Well, we're there," said panelist Richard Shea, vice president of acquisitions for PNC Real Estate.

A Balancing Act

It's no secret that investors playing catch-up on their Community Investment Act (CRA) requirements are driving up prices, said Kim Pardoe, a senior vice president of acquisitions at The Richman Group. Economic investors are also playing a role, as evidenced by the fact that developers in virtually every state – not just the CRA markets – are able to find equity. "Pricing right now is great for developers, but there's going to be, not a downturn, but a shift, and we're going to have to be light on our feet," Shea said.

With yields hovering below 5 percent, that shift is likely to stem from the departure of economic investors, which the syndicator panelists said are beginning to pull out of multi-investor funds. Some industry participants have drawn parallels between today's LIHTC market and that of 2005, said Russell Ginise, managing director, tax credit investments at RBC Capital Markets. Then too, yields dropped below 5 percent, but that resulted from Fannie Mae and Freddie Mac's aggressive investment, said Raoul Moore, senior vice president of tax credit syndication for Enterprise Community Investment.

Still, while panelists said today's market is very different from 2005, it is similarly volatile. Just 18 months ago, yields hit 13 percent and insurance companies entered the market in droves, constituting about 25 percent of the investor base in 2009. In 2012, if yields stay where they are now, insurance companies may not be able to justify investing in LIHTCs at the same level as they did in 2011, Ginise said.

"There will have to be some moderation at some point to bring things back to an equilibrium," Shea said.

What Goes Up, Keeps Going Up

The call for moderation is not an unfamiliar one. Last fall, when prices jumped to the 90-cent range, syndicators said pricing was getting too hot, too fast and threatening the market's long-term stability. They called for balance between prices and yields. For the health of the industry, they cautioned developers not to focus on short-term gains by pushing for higher credit prices.

They also predicted it wouldn't be long before the market corrected itself, but between last year and this year, the average credit price has risen nearly 15 cents. The elevated pricing has lasted long enough for experts to examine some of its effects

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on the industry and add some new cautions to the mix.

Eroding Deal Terms

Developers have enjoyed the recent high credit prices, but having so much money going after fewer deals comes with consequences. With so many investors competing for the same deals, they can outprice each other only to a certain point, Ginise said, so when pricing is equivalent, deal terms are the only bargaining chips remaining. Ginise and Pardoe said that in isolated cases they would consider making small adjustments to the length of guarantees, operating deficit guarantees and guarantor strength, depending on the property location and the developer's track record. However, Ginise said RBC is starting to see developers ask for looser terms on virtually every deal and that maintaining discipline is important.

"There's been a slippage in deal terms in a way that potentially harms the industry," said panel moderator Jana Cohen Barbe, partner at SNR Denton. Giving up ground on operating reserves and the requirement to maintain those reserves through the compliance period could jeopardize the viability of a project, she added.

"To see deals where the developers are demanding disbursement of the reserves as a fee at the end of three years is a really dangerous turn of events and not in the best interests of a project," Barbe said, citing the LIHTC's extremely low recapture rate. "If developers don't stand behind the project, if we don't build solid projects, if we don't feed the projects and support the projects, at some point the projects will suffer, the industry's reputation will suffer and IRS may take notice."

Moore said Enterprise has seen pressure on deal terms such as length of guarantees, but early release of operating reserves is rare because most investors will not accept it prior to the end of the compliance period. "There has been some backsliding on deal terms but it's nowhere near the level we saw before the meltdown," he said.

"I am finding that investors are holding strong on keeping those reserves in the deal for the 15 years, and that's different than it was in 2005," Pardoe said, noting that in most deals during that time, investors released reserves after the end of the operating deficit guarantees.

Only the Strong Survived

Pricing aside, the quality of the investment product and the strength of deals and sponsors have never been stronger, said Ginise. "If you're a real estate developer and you came through the last few years and you're still standing, that's pretty solid because a lot of folks got washed out," he said.

The same is also true for syndicators. "The syndicators that survived the economic downturn are generally syndicators of real

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Novogradac Journal of Tax Credits Information

Address all correspondence and editorial submissions to:
Alex Ruiz/ 415.356.8088

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ISSN 2152-646X

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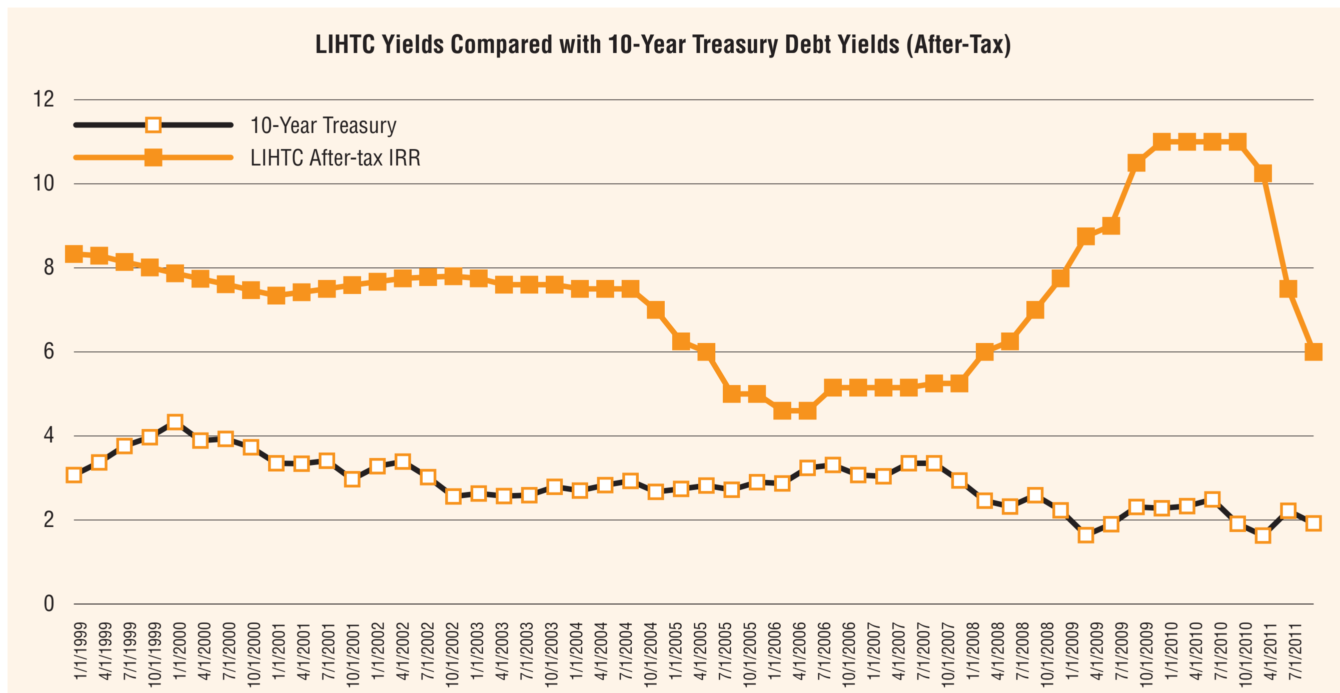

Source: PNC Real Estate; Novogradac & Company LLP, October 2011

quality," Barbe said. "They're performing asset management and they are one of the keys to policing the industry in a lot of respects." One of the reasons that extremely high credit prices are troubling, she said, is because it makes it difficult for syndicators to make enough money to fund their asset management businesses.

"It would be unhealthy if pricing gets so squeezed that we can't fund asset management," Barbe said. "I don't happen to think it's healthy for the industry to pay more than a dollar-for-dollar in credit. I don't think highly-leveraged bond deals are healthy for the industry. I don't think floating rate debt is healthy for the industry. Those are things we're starting to see again that make me nervous."

But despite those concerns, Barbe said, the fact that the recent resurgence has happened without the aid of Fannie Mae and Freddie Mac is promising because it finally gives the market a chance to perform under "true supply-and-demand economics."

Looking ahead to next year, the panelists predicted a fairly stable overall market, with a possible slight drop in pricing accompanied by higher yields. In California, Shea said, the loss of redevelopment agency funds is expected to put more pressure on credit prices. ❖

This article first appeared in the November 2011 issue of the Novogradac Journal of Tax Credits.

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