Novogradac
Journal of Tax Credits
News, Analysis and Commentary On Affordable Housing, Community Development and Renewable Energy Tax Credits

August 2012, Volume III, Issue VIII
Published by Novogradac & Company LLP

Competing Interests, Falling Yields Create Conflict

By Jennifer Dockery, Assignment Editor, Novogradac & Company LLP

In today's low-income housing tax credit (LIHTC) market, competition is getting fierce. Community Reinvestment Act-motivated investors are vying against economic investors for a finite number of credits and syndicators are again seeing credit prices rise above the dollar mark. Uncertain tax policy and expiring provisions are also contributing to a challenging environment. According to syndicators, the LIHTC equity market has become red hot as yields fall and stakeholders search for some kind of equilibrium, which may be impossible to find until after the November elections.

It's Getting Hot in Here

The LIHTC market has recovered from its low point a few years ago. Economically motivated investors from outside the financial industry entered the market several years ago as yields rose and credit prices dropped. Now, the market has absorbed surplus tax credits, said Michael Gaber, WNC's chief operating officer (COO). This left the market a little sluggish until states awarded allocation to new properties, said Jeffrey Goldstein, Boston Capital's COO.

"The market appears to have absorbed much of the pent-up demand which drove yields down to a level that seems to have bottomed out after a roller coaster couple of years. We expect investor demand to remain strong for the remainder of 2012, due largely to low interest rates and a lack of fixed-income alternatives with a low risk profile and reasonable returns," said Gaber.

Robust CRA markets, such as New York, Chicago, Los Angeles, San Francisco, Miami and Philadelphia, have remained strong with prices rising above the dollar mark. Jeffrey Whiting, CEO of City Real Estate Advisors Inc. (CREA), attributes that strength to a selective loosening of terms, such as fewer personal guarantees and lower operating reserve requirements, for experienced developers. Christoph Gabler, AEGON USA Realty Advisors LLC's senior vice president of community investments, said that AEGON is seeing CRA-motivated buyers paying $1.05 in California and $1.08 in New York markets. Gabler and Goldstein have also seen pricing exceed a dollar in other CRA-desirable locations.

"Pricing has become very competitive in the last six months. One oddity is competing deals are bid up by five or six cents sometimes. No slight increments [are] made to win a deal," Gabler said.

In the rest of the country, pricing has been in the 80s to 90s. Goldstein has seen low- to mid-80s per credit while Whiting has seen prices around 90 cents. WNC's Gaber has seen prices at 80 cents and AEGON's Gabler reported prices ranging from 86 to 95 cents. Gabler has also watched prices rise as developers seek increasingly aggressive terms.

Because banks and other CRA-motivated investors are willing to pay higher prices for the credits, developers who accepted 83 to 85 cents per credit last year won't even consider that price today, Whiting said. He expects pricing to return to 2011 levels, and Gabler said that pricing was likely to drop in the next few months.

"I'm not optimistic that the market is going to sustain itself at these prices. It's all going to be based on the earnings of the financial sector. That's what's going to drive the pricing," Whiting said.

continued on page 2

continued from page 1

Falling Yields, Fewer Investors

Whiting, Goldstein and Gabler all cited a conflict between CRA-motivated investors and economic investors. CRA-motivated investors are paying upwards of one dollar for credits in popular markets, driving down yields. Economic investors, on the other hand, are looking for higher yields and a lower price per credit. The conflicting interests are creating two competing markets, Whiting and Goldstein said.

Direct buyers with CRA requirements are investing in properties with yields of less than 6 percent, said Goldstein. Multi-investor funds, which consist primarily of economic investors, want yields of at least 6.5 percent. He added that it is becoming more difficult to put together funds that provide a higher yield and that some economic investors are leaving the marketplace.

"You have a lot of equity that's interested in those credits and that's what is driving yields down," Goldstein said.

According to Whiting, credit pricing needs to come down because economic investors, who comprise about half the market, won't invest in properties that don't meet their minimum yield requirements. As yields fell below 7 percent, for example, Whiting saw a number of insurance companies leave the market. Gabler has also seen insurance companies exit the market because of falling yields. He said that some economic investors will invest in a few transactions that are above their yield floors and then back off as yields drop too low.

"Deals in key CRA markets will continue to drive up pricing as banks compete to deploy funds in their assessment areas. CRA needs to be changed but until it is, we will see bank competition result in such uneven pricing to the detriment of economic investors," Gabler said.

Election Year Challenges

The industry faces several challenges in the coming months, including economic uncertainty, the November elections and a potential reduction in the corporate tax rate.

Whiting said that economic uncertainty could drive away economic investors and Gabler expressed concern that national, state and local debt issues would draw attention away from the program. Gabler and Gaber both saw the expiring 9 percent credit floor as a challenge for the program. Other factors, such as changes to the tax code and even the European financial crisis, could make alternate investment opportunities seem more stable to economic investors than LIHTCs. "It doesn't matter where the yield is [if] they can go find investments that are more attractive to them," Whiting said.

A lower corporate tax rate could also affect the LIHTC market.

continued on page 3

Novogradac Journal of Tax Credits Editorial Board

PUBLISHER
Michael J. Novogradac, CPA

MANAGING EDITOR
Alex Ruiz

TECHNICAL EDITORS
Robert S. Thesman, CPA
James R. Kroger, CPA
Owen P. Gray, CPA
Thomas Boccia, CPA
Daniel J. Smith, CPA

ASSIGNMENT EDITOR
Jennifer Dockery

STAFF WRITER
Jennifer Hill

CONTRIBUTING WRITERS
Brandi Day
Chad Durden
Brad Elphick
Tony Grappone
Owen P. Gray
Jenny Ho
Jon Kelly
Peter Lawrence
John Leith-Tetrault
Rochelle Lento
Virginie Arnaud LePape
Forrest David Milder
Vincent Ravaschiere
Charles A. Rhuda III
Craig Staswick
John M. Tess

CARTOGRAPHER
David R. Grubman

PRODUCTION
Alexandra Louie
Jesse Barredo
James Matuszak

Novogradac Journal of Tax Credits Information

Correspondence and editorial submissions:
Alex Ruiz / 415.356.8088

Inquiries regarding advertising opportunities:
Emil Bagalso / 415.356.8037

Editorial material in this publication is for informational purposes only and should not be construed otherwise. Advice and interpretation regarding the low-income housing tax credit or any other material covered in this publication can only be obtained from your tax advisor.

NOVOGRADAC & COMPANY LLP®
CERTIFIED PUBLIC ACCOUNTANTS

© Novogradac & Company LLP
2012 All rights reserved.

ISSN 2152-646X

Reproduction of this publication in whole or in part in any form without written permission from the publisher is prohibited by law.

Novogradac Journal of Tax Credits Advisory Board

LOW-INCOME HOUSING TAX CREDITS

Bud Clarke	BOSTON FINANCIAL INVESTMENT MANAGEMENT
Jana Cohen Barbe	SNR DENTON
Tom Dixon	BOSTON CAPITAL
Rick Edson	HOUSING CAPITAL ADVISORS INC.
Richard Gerwitz	CITI COMMUNITY CAPITAL
Rochelle Lento	DYKEMA GOSSETT PLLC
John Lisella	U.S. BANCORP COMMUNITY DEV. CORP.
Phillip Melton	CENTERLINE CAPITAL GROUP
Thomas Morton	PILLSBURY WINTHROP SHAW PITTMAN LLP
Arnold Schuster	SNR DENTON
Mary Tingerthal	MINNESOTA HOUSING FINANCE AGENCY
Rob Wasserman	U.S. BANCORP COMMUNITY DEV. CORP.

PROPERTY COMPLIANCE

Sharon Jackman	SIG SERVICES LLC
Michael Kotin	KAY KAY REALTY
Michael Snowdon	MCA HOUSING PARTNERS
Gianna Solari	SOLARI ENTERPRISES
Ruth Theobald Probst	THEOPRO COMPLIANCE & CONSULT. INC.
Kimberly Taylor	HOUSING DEVELOPMENT CENTER

HOUSING AND URBAN DEVELOPMENT

Ray Landry	DAVIS-PENN MORTGAGE CO.
Sheldon Schreiberg	PEPPER HAMILTON LLP
Monica Sussman	NIXON PEABODY LLP

NEW MARKETS TAX CREDITS

Frank Altman	COMMUNITY REINVESTMENT FUND
Merrill Hoopengardner	ADVANTAGE CAPITAL
Scott Lindquist	SNR DENTON
Matthew Philpott	U.S. BANCORP COMMUNITY DEV. CORP.
Matthew Reilein	JPMORGAN CHASE BANK NA
Ruth Sparrow	FUTURES UNLIMITED LAW PC
Joseph Wesolowski	ENTERPRISE COMMUNITY INVESTMENT INC.

HISTORIC TAX CREDITS

Don Holm	HOLM LAW FIRM
John Leith-Tetrault	NATIONAL TRUST COMM. INVESTMENT CORP.
Bill MacRostie	MACROSTIE HISTORIC ADVISORS LLC
John Tess	HERITAGE CONSULTING GROUP

RENEWABLE ENERGY TAX CREDITS

Ben Cook	SOLARCITY CORPORATION
Jim Howard	DUDLEY VENTURES
Forrest Milder	NIXON PEABODY LLP
Darren Van't Hof	U.S. BANCORP COMMUNITY DEV. CORP.

continued from page 2

Congressional Democrats and Republicans as well as the president have proposed reductions in the corporate tax rate. Gabler said that some companies have already started modeling the probable outcomes and investment yields from lower tax rates. The November elections could play a significant role in determining a new tax rate.

"The biggest thing on the horizon is the election and how the government views and acts upon taxes going forward," Goldstein said.

This article first appeared in the August 2012 issue of the Novogradac Journal of Tax Credits.

© Novogradac & Company LLP 2012 - All Rights Reserved

Notice pursuant to IRS regulations: Any U.S. federal tax advice contained in this article is not intended to be used, and cannot be used, by any taxpayer for the purpose of avoiding penalties under the Internal Revenue Code; nor is any such advice intended to be used to support the promotion or marketing of a transaction. Any advice expressed in this article is limited to the federal tax issues addressed in it. Additional issues may exist outside the limited scope of any advice provided – any such advice does not consider or provide a conclusion with respect to any additional issues. Taxpayers contemplating undertaking a transaction should seek advice based on their particular circumstances.

This editorial material is for informational purposes only and should not be construed otherwise. Advice and interpretation regarding property compliance or any other material covered in this article can only be obtained from your tax advisor. For further information visit www.novoco.com.