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High LIHTC Pricing, Low Yields Lead to Investor Pushback

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It's a great time to build low-income housing tax credit (LIHTC) housing. The 9 percent credit minimum was made permanent in December, bipartisan legislation has been introduced to increase allocation authority by 50 percent and the economy has recovered enough for LIHTCs to command top-dollar pricing. The Novogradac Journal of Tax Credits surveyed investor and syndicator panelists from the Novogradac 2016 Affordable Housing Conference, who confirmed that robust investor appetite for the LIHTC created a new norm for both pricing and yields, which ultimately means more capital for building affordable housing. Stakeholders discussed the investor climate, the potential for new participants and upcoming challenges and opportunities for the LIHTC community.

"It continues to be a frothy, active market," said Richard Price, partner at Nixon Peabody. "There's lots of activity and motion, and the pricing is good." Price said that for subsidized, rural properties in areas not considered "hot" for Community Reinvestment Act (CRA) purposes, investors pay in the low- to mid-90-cent range for tax credits.

Strong deals in larger markets can typically fetch more than a dollar in investment for every tax credit dollar. Catherine Talbot, senior partner of Candeur Group, said that the lowest pricing she normally sees is about $1.04 or $1.05 per tax credit dollar, with highs of $1.20 for CRA transactions. Raoul Moore, senior vice president of tax credit syndication for Enterprise Community Investment, also reported credits easily going for more than a dollar each. "I'm not seeing any deals priced even in the high 90s, except maybe a few outliers. Most are above $1.20 in San Francisco and New York," said Moore.

In turn, investor yields have fallen to historic lows. "We have national multi-investor funds from 4 to 5 [percent]," said Stacie Nekus, senior vice president of investor relations for Alliant Capital. "The breaking point for the economic proprietary investor seems to be 4.25; that's an upper-tier yield." Meanwhile, investments in highly desirable CRA markets can have yields as low as 3 percent, or even slightly less.

Experts attribute the pricing and yield trends to CRA mandates driving competition for a limited supply of LIHTCs. "I think most people would agree that there's too much capital and not enough product," said Talbot. "We're likely back to where we were in 2006, before the financial crisis, except there's more discipline with deal terms."

continued on page 2

continued from page 1

Respondents said they don't expect prices will get much higher or yields much lower. "We're seeing investors push back. I think the market has bottomed out. Even CRA investors are pushing back on pricing and on people asking for terms outside of the box," said Moore. Moore said that some sponsors are asking for shorter guarantee periods and smaller operating reserves.

Others agreed. "We're starting to see some pushback from economic investors in terms of pricing and from some CRA investors, too," said Nekus. "If they're not getting construction lending opportunities, they're saying no."

Room for More?

A crowded investor field and rock-bottom returns have made it difficult for potential new investors to participate. When syndicators started putting out multi-tiered, multi-investor funds a few years ago, smaller regional banks were able to enter the investment space. Other than that, few new investors have entered the market *en masse* since then. "There's occasionally talk of new investors, but even if new investors come in, what do they buy?" said Talbot. "Funds are already oversubscribed." About two years ago, some tech companies expressed interest in becoming LIHTC investors. However, the yields were too low for them to get involved even then.

Some longtime investors have also considered heading to the sidelines for now. "What we've seen are some insurance companies sitting out in the short term as yields for national product dip below 5 percent," said Moore.

Fannie Mae and Freddie Mac

LIHTC investors are keeping their eyes open about the possibility of government enterprises Fannie Mae and Freddie Mac entering–or rather, reentering–the LIHTC marketplace. Fannie Mae and Freddie Mac provided about 35 to 40 percent of LIHTC annual investment before the national financial crisis. The government-sponsored enterprises were not motivated by the CRA, and so were more able to invest in rural areas, which tend to be outside CRA areas. However, their authority to invest essentially ended when they were placed into conservatorship in 2008.

The Federal Housing Finance Agency (FHFA) in December proposed a rule regarding the enterprises' duty to serve underserved markets, including affordable housing preservation and rural housing. Policy considerations associated with the proposed rule include whether Fannie Mae and Freddie Mac should be allowed to re-enter the LIHTC investment market in any capacity, and if so, whether they should be allowed to guarantee LIHTC investments, become limited partner equity owners, or both.

Reactions to the proposal among stakeholders are mixed. Some say that there is no public policy purpose to having government-supported institutions compete with private investors in what is already a robust and limited market. Opponents of the enterprises re-entering the marketplace argue that Fannie Mae and Freddie Mac might crowd out economic investors that provide diversity in the investor field.

Others are cautiously receptive to the idea of Fannie Mae and Freddie Mac finding and fulfilling needs that are not fully being met. Moore said that there may be a responsible way for the enterprises to finance mixed-income properties, highly focused supportive service developments and subsidized Section 8 overhang deals that would have substantial deficits if the subsidy were lost.

Some would like Fannie Mae and Freddie Mac to become active lenders in the affordable housing space. "In terms of that equity coming back to the market, I don't think we need it, but I think it would be great if they continued to lend, provide alternative financing sources

continued on page 3

continued from page 2

and possibly even develop a market as a guarantor of credits," said Nekus.

The Road Ahead

While investors continue to monitor trends in pricing, yields and deal terms, one long-term concern continues to be the potential implications of tax reform. Few believe that much headway can be made on tax reform during an election year, but the consensus among LIHTC participants is the importance of showing legislators how effective the LIHTC is in leveraging private investment for affordable housing development.

"One thing that impresses Capitol Hill is the efficiency of the program–a dollar in credits is close to a dollar in cash," said Price. "That's become a centerpiece of the tax credit's story."

Nekus said fighting to keep the LIHTC in the tax code is critical because no other initiative could come close to replacing it. "There's no better program out there that provides safe and affordable housing," said Nekus. "The LIHTC industry has shown we know how to do it and we know how to do it right."

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