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LIHTC Market Gets 'Back to Equilibrium' after 'Intense' 2016

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Low-income housing tax credit (LIHTC) transactions struggled to close, developers scrambled for gap funding to help their deals pencil out and state allocating agencies strategized to help prevent much-needed affordable housing developments from staying stuck in the pipeline. That was the story of the LIHTC market following November's presidential election through the first few months of 2017–a far cry from the "frothy" investment landscape that characterized the better part of 2016. Fortunately for the affordable housing community, industry experts herald a stabilized market as investors return, albeit at different pricing and yield parameters.

"Different than the financial crisis of 2008, investors remain attracted to LIHTC investing," said Beth Stohr, director of LIHTC investments for U.S. Bank. "It was the uncertainty of the market that got investing off to a slow start this year, but there continues to be interest built up every week and you're definitely going to see more and more active engagement in investment as the year rolls forward."

Pricing and Yields

Investors saw the election of a Republican president and a continued Republican majority in Congress as a signal that tax reform and lower corporate tax rates were imminent or at the very least, likely. The Trump administration proposed dropping the top corporate tax rate from 35 percent to 15 percent, while a 2016 House Republican tax blueprint proposed a 20 percent rate. Legislators have yet to finalize a corporate tax rate change, but the mere uncertainty already had significant consequences.

Since this time last year, pricing for the LIHTC has dropped about 10 to 20 cents per dollar. According to investors surveyed in the LIHTC market update featured in the Novogradac Journal of Tax Credits July 2016 issue, investors last year typically paid in the low- to mid-90-cent range for tax credit investments in areas not targeted for Community Reinvestment Act (CRA) consideration. Pricing for CRA-motivated investments exceeded a dollar per tax credit, with some investors observing as much as $1.20 per credit in hot markets like San Francisco and New York City.

continued on page 2

continued from page 1

That was last year.

"Pricing right now, depending on how desirable it is for CRA, is from the low 80s to right about a dollar or high 90s," said Raoul Moore, senior vice president of tax credit syndication for Enterprise Community Investment Inc. "Whereas before, the election and change in market pricing, it had been pretty much across-the-board a dollar up to astronomical numbers in the highly desirable CRA areas."

Others agreed. Jennifer Seamons, senior vice president at Key Community Development Corporation, said she typically sees a range of high-80s to mid-90s, with CRA areas up to a dollar per credit or a bit more. Jessica Cometa, senior relationship manager for WNC, said she has seen bids from 85 cents to 96 cents in the past few months.

Stohr said a drop in pricing would have been likely even without the implications of the election.

"Twenty-sixteen was a very intense year," said Stohr. "Any time you come off peak investment, you're likely to see a change. It was not surprising that folks would take a pause in the first quarter anyway, but with the uncertainty of tax reform added, it was a little bit of a double whammy."

Yields before the election were at historic lows. National multi-investor funds were at about 4 to 5 percent, with some in highly desirable CRA markets as low as 3 percent. Last year's bottomed-out returns sent many economic investors to the sidelines.

This year, the hottest CRA areas are still in the 3 to 5 percent range, but economic investors are slowly coming back as national product yields climb to a more palatable low-to-mid-5 percent range. "I've seen a couple of new investors that have returned to the market a bit because with lower pricing, there are increased yields," said Seamons. "There's an economic benefit to these funds at this point. It's a very safe investment in terms of the asset class."

Stohr says these normalized market conditions after a peak year are healthy for the industry. "This is a sustainable level in the marketplace," said Stohr. "You want a broad base of investors, which you can't get when deals are 10 cents higher than they are."

Underwriting in Uncertainty

The legislative uncertainty makes underwriting a challenge. "We saw pricing drop tremendously, adjusters and all sorts of machinations of the impact that tax reform could happen," said Seamons. "We are now in a bit of a more temperate approach, with investors getting more comfortable with the idea of underwriting to a specific tax rate without upward or downward adjusters."

Moore said that the question of the day is where corporate tax rates will end up settling. "It's anybody's guess right now," said Moore. "Most investors were initially underwriting at 20 percent tax rate, but a lot of the market is settled in right now at 25 percent."

Cometa said that this is likely to change if tax reform uncertainty continues through the end of 2017. "If nothing happens this year, a lot of transactions are going to resist being underwritten to a 25 percent corporate tax rate and you'll have a lot of pushback from developers for investors to use anything from 28 up to the 35 percent rate," said Cometa.

Continued Commitment

Despite tax reform uncertainty, investors underscored their commitment to the LIHTC program.

"I would say that the appetite is still there at the right deal terms for investors," said Cometa. "Investors are

continued on page 3

continued from page 2

going to be active regardless, considering many are driven by CRA need and other factors. We're just seeing pushback on terms."

Seamons agreed. "In spite of the fact that there's uncertainty in tax reform and the implications of what that would look like, we are still committed to investing in affordable housing," said Seamons. "While we have modified our underwriting to account for the impacts of potential tax reform, we've actually increased the volume that we want to invest this year over last year, which I think shows the value that we see in this industry."

The industry's commitment to providing affordable housing includes continued efforts in Washington to urge lawmakers to maintain and enhance the LIHTC in tax reform. "The industry as a whole has done a really good job of educating our elected officials about the Low-Income Housing Tax Credit program," said Moore. "As our legislators change out and new ones come in, we have to continue to be really vigilant about getting elected officials out into their districts and states and see what's actually getting built. That's the single most important way to make sure that our congressional leaders understand the benefits of the tax credit program."

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