The United States is experiencing the highest rate of inflation since the low-income housing tax credit (LIHTC) became a permanent part of the tax code and rising costs have a combination of effects on operators and tenants of LIHTC properties. In this week's episode of Tax Credit Tuesday, Michael Novogradac, CPA, and Novogradac partner Blair Kincer, MAI, CRE, discuss the ways inflation can affect LIHTC development costs, operating expenses, financing and operating revenue. They also discuss how utility expenses are affected and compare this scenario to the Great Recession.

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Transcript

[00:00:10] **Michael Novogradac, CPA** Hello. I'm Michael Novogradac. And this is Tax Credit Tuesday. This is the March 1st, 2022, podcast.

Today, we're going to talk about something that has received quite a bit of attention recently: inflation or more accurately, the effects of inflation. If you follow the headlines, you know that inflation is at the highest rate in nearly 40 years. The year-over-year increase in the consumer price index for January, a common measure of inflation, was 7.5%. That's the highest rate for any month since June of 1982, this according to the Bureau of Labor Statistics. The increase in the CPI for the month of January alone was 0.84%. That's the increase in January from December. This is an increase that translates into a whopping 10.4% on an annualized basis. Now, obviously I don't think that's what the current inflation rate is and there's a variety of factors why December to January might go up higher than the average, but that is a pretty substantial increase.

We don't know if this high year-over-year inflation is going to continue for the next few years or if what we're actually witnessing is a temporary increase that may begin to wane in the late summer into early fall. One thing we do know is that the inflation rate for calendar year 2021 was 7%. And that was the highest for any year since the low-income housing tax credit was enacted. I'll say that again. That was the highest rate of inflation for any year since the low-income housing tax credit was enacted.

Before 2021 and since the Great Recession, the actual year-over-year inflation rate was consistently below 3.75% with an average inflation rate of 1.65%, which basically means the January year-over-year inflation rate was more than double the peak since the Great Recession. I share these historical dates and inflation rates to emphasize that we are in the midst of inflation rates that have never been experienced by the low-income housing tax credit community before. Hence the focus of this week's podcast, which will be how an increase in inflation affects the development, financing and operations of low-income housing tax credit properties.

Now the genesis of this podcast, as for many podcasts, is what we're hearing from our clients–from developers, investors, underwriters, lenders, syndicators, property managers and many others. They're asking us how inflation will affect their properties, how it'll affect those properties already in service, those under construction and those still in pre-development. And then they also want to know what the impact of inflation will be on their residents and will it lead to rising rents? Will it also lead to rising incomes? As I said earlier, we don't know what the rate of inflation will be in the future. Will it rise even more? Will it fall? Will it stay in the current range?

I'm certainly hoping that this podcast won't have a long shelf life and we will have inflation that gets back to more traditional levels of more recent years, but high inflation does affect virtually every area of affordable housing development and operations. With the higher the rate, the greater the effect. So we do need to address this issue and plan in the event that this inflation is more enduring. This week's podcast is also an extension of my March column in the Novogradac Journal of Tax Credits, which addresses the possible effects of inflation on affordable housing. I will share a link to my column if you're interested in further reading.

Now, here are two key points that are going to be part of today's discussion: First, inflation hits development costs and operating expenses immediately, or almost immediately. If you're building, you know that construction costs have increased greatly in the past year-plus. If you're operating a property, you also know that many of your operating expenses have increased significantly.

Now the second key point of this podcast is that while inflation does generally increase many financing sources and operating revenue, those increases generally take a year or more to be realized. So basically costs go up, expenses go up first, additional financing sources and operating revenue come a little bit later.

Now to discuss this very timely topic, I have my partner Blair Kincer joining me today. Blair works out of our Washington, D.C., office and co-leads the company's Government Consulting and Valuation advisory services group, or GoVal. Blair specializes in market analysis and appraisal in a variety of incentives and is our in-house expert on all things data and what they mean.

In today's podcast, we'll discuss how inflation affects or might affect development costs, financing sources, operating expenses and property revenue. As such, our discussion will be separated into these four key areas. Once again, development costs, correlated financing sources, operating expenses and property revenue. Now the effect of high inflation on low-income housing tax credit development and operations is a multi-dimensional and interconnected issue. I say that because this podcast isn't going to say exactly what all those interactions are going to be. It's really intended to be the start of a discussion to highlight some of the interconnectivities to be aware of and also to ask our listeners to share more of what they're seeing. So as you can see from this intro, there's a lot to discuss. So if you're ready, let's get started.

Blair, welcome back to Tax Credit Tuesday.

[00:06:15] **Blair Kincer, MAI, CRE:** Thanks, Mike, it's good to be back.

Inflation and Development Costs

[00:06:18] **Michael Novogradac, CPA** So let's start today's discussion by talking about the areas where we see inflation affecting operations and development first. And as I noted in the introduction, most properties have a development phase and then they have the operating phase. And then within the development phase, developers have to estimate project costs and the sources of financing to fund those costs, your classic sources and uses, uses and sources. And then during the operating phase, developers have to budget and project annual revenues and their annual expenses, income and expenses. So I figured we'd start with the development costs, which is an area that is the first place that many stakeholders will see the effects of inflation and potentially in an absolute and nominal dollar amounts will see the greater impact. Now in my column in the Novogradac Journal of Tax Credits, I shared that building materials increased by more than 14% in 2021 and that the construction industry is facing a worker shortage. So Blair, you speak with a lot of people and work in this world every day. What are you seeing in terms of inflation impacts on development costs?

[00:07:36] **Blair Kincer, MAI, CRE:** Well, thanks Mike. First, I want to focus on that 14% increase in construction costs because that's what I'm hearing a lot about from my clients. They're very focused on that, but when they compare that to CPI, I sometimes think we lose a little bit of the discussion because CPI is a broad measure of inflation. Often, they say it's a basket of goods. Currently inflation could be driven by food prices and used car prices and energy prices. However, apartment developers aren't really focused on food prices and used car prices, they're more focused on the construction. And so that's why you get that a little bit of disconnect between 14% increase in construction costs. One difference is, and it's a large one, it's the dramatic increase in lumber prices. That began before COVID, before we see this significant increase in CPI. I think lumber costs are the poster child of supply chain disruption. Prior to the pandemic, some of my clients saw lumber prices going up and they saw a decrease in imports from Canada as being a possible reason for that because of tariff issues and then COVID hit. We do some work in Maine and I'm familiar with that geography. When you talk to developers up there they talk about timber crews are small and one guy goes or one man or woman goes sick, the crew shuts down. And so you have less supply coming out of the forest themselves because of COVID and then the lumber gets to the mill, to the lumberyard or the milling and they've had problems wrestling with COVID. Then finally it has to be delivered and that's the ultimate supply chain problem. Lumber really shows us how this is a multifaceted and a long-term–long-term being past three years–issue. Then you mentioned this your article, one of our clients, Shannon Tutor, tells a great story about when he was developing a property in Kentucky, he actually had trouble getting enough appliances and he had to start going around from store to store to buy appliances at increasing costs every store he went to. So it's not just lumber, it's not just payroll, which it is of course for both. But it's almost every aspect. And then I start thinking about the future, Mike, and I think, OK, so what's next? How about land prices? I hear some of my clients starting to, I don't want to use the word complain, but let's just say discuss the impact of land prices, because that has a multi-layered effect on tax credit development because of the basis issue. That's what I'm hearing from my clients. They love to go back to the lumber discussion because it's so clear and then they layer that on top of, but hey, it's not just lumber it's appliances, and then they say, but what about land prices, Blair? What are you seeing there?

[00:10:28] **Michael Novogradac, CPA** Yeah, and then steel and so all the others, so it's definitely a complex question and as I noted, that is an area where you see inflation hitting the costs first and it's affecting the budgets first and then also leads to challenges in getting estimates when you're going in and applying for a tax credit award and the rest, because how firm is your construction cost estimate given when you'll actually apply for the award versus get the award and then actually start construction.

But let's not go into all those other details. There's a lot of nuances and areas that we could sort of dig down, but I did want to talk about the other area where low-income housing tax credit developers and property managers see the more immediate effect of inflation. And that has to do with the operating expense side for those properties that are obviously in operation, as well as for those properties under development, that have to project out what their operating is going to be when they're sizing up the loan in determining financial feasibility. So as you talk with developers and property managers, what are you hearing about operating expenses?

Inflation and Operating Expenses

[00:11:37] **Blair Kincer, MAI, CRE:** Well, I think you make the point earlier that inflation is going to impact all of these categories and I think I'm hearing is it is going to affect all of these categories, but it's at a different pace for each one. And then going back to my point about the lumber, we've seen increases that predate this inflationary period, particularly with insurance and particularly with repairs and maintenance. So those past increases are going to be exacerbated by increases in inflation. Inflation is going to impact it differently. Referring back to my point about CPI being a broad measure, again, it's about stuff. And sometimes I think about inflation as being it's going to more directly impact the purchases of stuff first and then and payroll and insurance secondly.

I think we can look at the repairs and maintenance. You're going to see the inflation issue impact that more quickly because that's where you're buying stuff. That's where you're buying paint. That's where you are buying lumber sometimes for repairs or doors or appliances as we've mentioned. You're going to see a more filtered impact when it comes to payroll and taxes and utilities. It's definitely a multi-variable equation. And one thing we saw in the last recession, the Great Recession versus this current COVID economic turmoil is that there are going to be greater efficiencies. You know, we do learn during periods of recession and one thing I heard after the Great Recession, one thing I've heard recently in this period is that we've learned how to be more efficient.

So it's going to be a multi-variable equation where we are going to see some increases because of direct inflation, but we're also going to see some savings that we're going to be able to reap because we've learned and I find that encouraging and confounding at the same time.

[00:13:23] **Michael Novogradac, CPA** So you did mention how the inflation is affecting different expenses on a different timeline. Maybe you could share some of those expenses that see a more immediate effect from inflation and some of those expenses that might be a little bit more delayed in terms of when those effects of inflation flow through to the operating expense side.

[00:13:45] **Blair Kincer, MAI, CRE:** Sure. And I think the first one that comes to mind is repairs and maintenance. As I said, that’s stuff, that's tools, that's equipment, paint and cleaning supplies, that kind of thing. Payroll is going to be one that it will be affected, but it there'll be a lag because there is going to be a lag between inflation and then people achieving and obtaining raises. Think utilities: most utilities have to be increased through a utility commission so you're not going to see as quick of an increase there. Clearly right now we're in an oil shock, heating oil is up 70 cents year to date. That's a significant increase and a lot of properties in Vermont and Maine heat with oil so that's a significant increase, but that nationally again, we're talking about local versus national, nationally, most properties heat with natural gas and going back to 2009, gas prices have been very stable and that's concurrent with the robust supply gains from fracking. I'm not going to say that’s causal, but it's very concurrent, it's very obvious. You know, we may need to see more sustained inflation to really affect that natural gas pricing because of that stability. Again, speaking of electricity and we're speaking about electricity, since 2008, it's only increased about 1% per annum. Again, the cheaper gas has played a role in that as has the increase in renewables. So right now we're looking at 20% of electricity generation is from renewables. So maybe that would be one of those impacts that might be a little bit longer term as we watch that unfold.

I think again, another one that could be longer term is property taxes. Fundamentally, property tax is a function of your assessment times millage rate. Properties assess annually and you could see increases next year or the year after in your assessment. A lot of states do not assess annually and you may have a longer delay on any increased assessment. The millage? Some municipalities facing increased cost of goods and payroll may increase a millage rate significantly, but again, that's a very difficult thing to do, politically, but also it's something that would be delayed because milling rates I'm paying today have been decided in previous years.

Inflation and LIHTC Financing

[00:16:02] **Michael Novogradac, CPA** So thanks for that discussion of the two areas. When I think about the impact of inflation get hit first, which are negative from the standpoint of operating and developing affordable housing, being development costs see a pretty immediate effect from inflation and the operating expenses seeing a pretty immediate effect of inflation. And I do appreciate your pointing out that in my intro, I talked about CPI, but I'm not sure to what extent developers, when they're looking at their construction costs and the rest, really care what CPI is. They care about what the inflation is with respect to materials they need and wage rates and the rest, which as you point out are notably different. And then on operating expenses, similarly, it's not so much what CPI is as much as what's the inflation rate with the individual categories of expenses.

But I did want to switch now to the sources side of the development budget and the operating revenue side of a rental property. Let's start with the sources to that we do have ongoing inflation at a high rate.

When I think about low-income housing tax credit financing, I always think about three major buckets. I think of in terms of sources of revenue–sources of funds to finance the development and lease up. And they are, of course, the equity from the tax credits, the foundation.

There's also debt, hard debt, if you will, debt that can be borrowed based upon the net operating income stream being projected.

And then the third category is the soft financing. The additional financing needed from government and other agencies to have enough sources to fund the development. And maybe you could share, maybe you could talk about each of those three categories and how you see inflation affecting them.

[00:17:53] **Blair Kincer, MAI, CRE:** Well, it's interesting. The way I look at it is kind of in descending order. First lending, then the equity and then the soft financing. But certainly, inflation translates into higher cost of funds, meaning higher interest rates, lower tax credit equity prices. Again, the timing might be delayed as interest rates and equity prices will react to inflation less directly. There will be some delay there, but there could be some significant pinching of sources for a developer.

[00:18:21] **Michael Novogradac, CPA** Let me just interject there that one thing that is also interesting with respect to this whole inflation is your operating expenses on an annual basis, your development costs on an annual basis are really based upon current inflation and your debt levels and your equity pricing is really based on projected inflation. And there can be pretty different views as to is this what's the long-term view of inflation. Maybe what's the long-term 10-year Treasury, how's it changing versus what's the one-year annual rate. And it's interesting to think about that debt and equity being a little bit more muted in the effects to the extent that the markets believe this is a more temporary amount of inflation, but to the extent the markets start to believe this inflation is more endemic then you would see a more, a stronger effect. Anyways, I just wanted to point that out. Please continue.

[00:19:10] **Blair Kincer, MAI, CRE:** I think it's a great point. I was kidding you earlier that I was in college and graduate school in the late ’80s and we talked a lot about inflation then. And one of my buddies and I were talking about this podcast and he said, Blair, we haven't talked about inflation in 10 years, 20 years. He's like I had to go back and look at some of my old notes about it to really refresh my memory about what it was like. But in his point was as your point is that, is this a price correction? Are we simply in a very noisy period with a lot of price corrections happening at one point in time or are we watching the devaluation of currency over a longer period? I don't know. My friend didn't know, but it's a fun topic, at least for weird people like me. But one of the points I was going to make, and I think you actually made it in your article, is that a 100 basis point rise in interest rates the declines the borrowing proceeds about 10%. There is a direct relationship from a higher interest rate and what you're going to have on your capital stack and I think that's an important thing to keep in mind. Then I'm going to also say, but this is a real iterative process, because at the same time, you may have a more robust NOI that you can show because you've had some increases in revenue that maybe exceed your costs. So it's a multi-variable equation and it's a lot of moving parts and of moving parts that I don't want to try to predict. So it's a conundrum at times.

Then going to that final part that, that soft funding, the soft sources. Clearly in an inflationary era, we're going to see more sources, we're going to see more availability of funds to local governments and state governments. I think one of the questions we have to ask ourselves is will those additional funding source resources, will they be allocated to housing, to affordable housing? And how much of a delay will we see? I think that's one thing we're going to have to watch because we know that there's the amount of private activity allocation, the amount of credits that definitely are impacted by an inflation factor. So I think that's something watch and to pay attention to as well.

[00:21:30] **Michael Novogradac, CPA** Yeah, it is interesting to think about on the equity financing side of tax credit properties, that if you're financing with a 4% credit. I mean there you actually do see a pretty immediate effect in terms of additional sources in the sense that the 4% credits aren't capped, the bond allocation is capped and you have to finance 50% more than 50% of your project with private activity bonds, so you have to be careful with cost increases causing you need larger bond allocations and states as a consequence, maybe they won't be able to allocate to quite as many transactions and quite as many developments, but the properties themselves as they have these higher costs do get the 4% credit on those higher eligible basis related costs. Obviously a 4% credit doesn't cover all of the increasing costs, you can't make it up in volume, but it is additive and it is one of the few ways where on the resource side, it's a fairly direct effect in terms of additional revenue. I'd also note that on the, I made the comment that the states being able to do quite as many transactions because more bonds have to go in a given one, there is a CPI adjustment, a cost of living adjustment for the amounts of bonds that go to state agencies. So they will on a delayed basis, on a one-year sort of delayed basis, see additional bond buying authority. And then the same thing happens with the 9% credits. They would see additional credits, based upon the inflation factor. Historically the inflation factor hasn't generated as much because inflation factors are lower, but it would lead to additional increases in credit to states to have once again, on a delayed basis.

So, you know, there's a lot of variables on the sources side developers and underwriters and the rest will need to be taking into account. It probably also demonstrates how important financial forecasts are and stressing financial forecasts. And I do know that one area where I think this podcast is going to be helpful is for those that are underwriting transactions to think of different additional stresses to run so that they know that during the whole development phase, through lease-up, depending upon what the rate of inflation is that the project can withstand the stresses of a reasonable range of inflation in the coming months.

Inflation and Operating Revenue

We talked about the sources for the development phase, now let's talk about revenue, the operating revenue for properties, either those under development, when you're projecting out what your property revenue is, as well as existing properties. And just to sort of level set for the listeners. Many of you will know this already, but just to make sure we're all on the same page, rent and income limits are released once a year by HUD around April 1st and these rent and income limits are what are used in order to determine the maximum rents that can be charged on the tax-credit property. So the revenues themselves, because these releases come out once a year, you know that you're not going to see the impact of inflation, at least until those numbers are released the following April 1st. So that's why when I mentioned there's a delay in revenue, well clearly there's a delay because of the time it takes for the government to release the updated income and rent numbers.

Note, though, it's a little bit more nuanced in terms of how inflation actually affects those limits, because in terms of calculating the maximum income levels and corresponding rent levels, HUD starts with nominal income estimates, area median income estimates, nominal amounts that are three years old. Basically, the most current data that HUD has that they can use is three years old. So then they basically take three-year-old income data and then they do adjust it forward based upon the consumer price index or CPI estimates. So what that means, for example, is for the 2022 rent and income limits, that we expect to be out in the next couple of months, there'll be based on the 2019 American Community Survey data and then that 2019 data gets adjusted by the CPI. So that's how that, so that's a little bit blurry there and Blair, maybe you can help unpack my overview to the listener. Then you could explain it a different way to try and make a little bit clearer for the listeners who I didn't adequately level set. Then you can also maybe talk about there's one thing in terms of HUD calculating numbers, another thing for what the qualifying tenants' income is likely to be, or at least some of the concerns or opportunities.

And I did want to actually put a plug in here for Thomas Stagg, our partner. Thomas Stagg has an income limits working group and one of the tasks that he's going to be looking at in the coming weeks and months ahead is how this interaction between inflation, ACS estimates and the three-year growth factor could it be affecting income levels in the coming years? If you want to know more about that income limits working group, just shoot Blair or me and email.

[00:26:41] **Blair Kincer, MAI, CRE:** Everything I know about AMI calculation comes from Thomas Stagg. So hopefully I can do him some justice.

[00:26:49] **Michael Novogradac, CPA** You are not alone. There are many in that category.

[00:26:50] **Blair Kincer, MAI, CRE:** Right. So the way I always think about how does inflation show up in the AMI calculation is it's the actual formula itself, but obviously the first way is, as you said, it's that inflation adjustment of the three-year-old data. And then I think about it, but it also shows up in year-over-year increase that I would see from like 2019 to 2020, for instance, for next year that is the inflation impacting the individuals or the median income. That's the way I like to think about it, but of course then as you say, the reality is that a tenant or a prospective tenant's income may not be matching median income growth.

[00:27:31] **Michael Novogradac, CPA** Let me actually interject before you talk about the tenants just to, when you gave the example of 2019 to 2020, 2018 to 2019 or something might be a better example because as you know, 2020, because of COVID, we don't have good American Community Survey data.

[00:28:45] **Blair Kincer, MAI, CRE:** That's a fair point.

[00:28:47] **Michael Novogradac, CPA** 2020 in and of itself is another whole area that Thomas Stagg and the income limits working group is working on. I don't want to go sideways on this podcast, but I'm sure there's a listener or two that heard your example, of 2019 to 2020 and thinking, but ... Hopefully by 2021, we'll be back to being able to have a good data collection. But anyways, I get you off track, please go back and talk about it's one thing to have these maximum rent levels. Now talk about what happens at what the variables are at the tenant level.

[00:28:20] **Blair Kincer, MAI, CRE:** Sure. And thanks for that. It was a very good point to make about 2020. And I think we'll talk a little bit more about that foreshadowing for next week's podcast.

[00:28:27] **Michael Novogradac, CPA** Yes.

[00:28:30] **Blair Kincer, MAI, CRE:** Tenant earnings. So there, the reality of what the tenant is actually earning and again, earlier I said about CPI is that basket of goods. Well now I'm going to make the point that tenants do buy food and tenants do buy used cars and tenants do buy fuel, so the impact on inflation on them is actually a little less muddled than it is for developers and property managers. For tenants, inflation tends to hit living costs before it hits wage increases and that's worsening an economic pinch on low income households so that's a very real thing to consider in this process.

Right now, currently, payroll is increases is trailing inflation. We made the point earlier that we have the highest inflation in 40 years. We have the highest wage increases in 20 years. Now that's good news for the wage increases in highest in 20 years, but compare it to the inflation highest in 40 years, you see that we're losing some purchasing power and that's happening at the same time that you and I drive down the road and we see McDonald's signs begging for people to come and work at wages that are higher. That's continued good news for these lowest-income cohorts: recent data, economic data post-Great Recession, seemed to suggest that the lower-income earners were at least keeping pace with inflation. Many economists noted that this is significant positive change from years prior. However, this data is fraught with noise because we know that 2021 period was affected by large amounts of government payments and I think there's a question that we have to ask ourselves and we have to think about is what's the economy going to return to? We hope it continues to show that in income for the lower economic cohorts but we don't know. Again, as the limits go up, will the tenants be able to afford it? We're going to talk some more about this again, fortunately, in our podcast next week, but that's a real question that my clients are asking–this differential between max rents and what tenants can actually pay and what tenants are actually able to pay.

[00:30:36] **Michael Novogradac, CPA** So thank you for that sort of overview of that discussion, a pretty critical question and a lot of listeners will be underwriters, developers, syndicators, investors. Given this question about how any immediate incomes might rise and the more significant question of to what extent will the income of lower-wage workers keep pace such that they can afford the increasing rents, what advice do you have for me when I go and I do my underwriting?

[00:31:09] **Blair Kincer, MAI, CRE:** I think it's a time-tested old advice that local characteristics matter. Where do these tenants work, is it reasonable to expect inflationary increases? If a property is dependent upon tourism jobs, they're in a different situation than one dependent upon construction jobs.

Those things, local issues, matter. Another thing we're hearing more of is there's a broad spectrum of outcomes for tenants. We are in an affordable housing crisis. We know there is a significant amount of demand for affordable housing. A lot of property managers are facing is the fact that despite increases in the max rents, they have tenants who can't afford to pay rents. And so they have tenants in place who can't afford to pay max rents. However, a new property could open up and fill up immediately with tenants paying max rent because of this excessive demand. So you have the economy in the marketplace where some properties may not be achieving max rents, but that doesn't mean that a new property opening across the street won't be able to simply because of this robust demand for affordable housing. Again, we're going to talk a little bit more in depth about that next week, because that's a real issue when reading markets and when an underwriter's reading a market, they may see that and that could give someone a pause, "Wait a minute, how do I know that max rents are achievable I see this happening?" So that's an important characteristic or important phenomena that we're seeing right now.

Inflation and Utility Allowances

[00:32:41] **Michael Novogradac, CPA** I am looking forward to the podcast next week to dig a little bit deeper into a lot of those sort of issues because this has definitely been, in the last year-plus, a really unique period to try to assess local markets from a market-demand perspective. But one thing I want to make sure on the revenue side we touched upon, and once again we need to do this really briefly, is utility allowances, because I mentioned how HUD will release the max income and rent numbers and then they have to be adjusted for a utility allowance. So that's a deduction if you will, from the gross rent. And then the question becomes, OK, how is that deduction affected by inflation? Maybe you could share some brief thoughts, but the utility allowance question is really a complex question, which we can't go into too much detail here.

[00:33:28] **Blair Kincer, MAI, CRE:** I think it is a complex question, but the way I'm conceiving of it in my head is that it's almost a double delay, because as I said earlier, utility increases are going to be delayed but then there's going to be a second delay as utility allowances are adjusted as utility audits are processed through. So I think that I view it as a double delay in terms of the impact of the utility allowance.

[00:33:55] **Michael Novogradac, CPA** Right. Which you know that first delay, the delay in the utilities rising in the charges to the users, that delay benefits both the tenant and the landlord. Once the utilities do go up, such as tenants are actually paying higher utilities, until the utility allowance gets adjusted, the tenants facing higher utilities but not seeing the adjustment or an allowance for the adjustment to the rent.

And in that case, it's adversely affecting the tenant only, so it will be interesting to see to what extent that utility allowances get updated more quickly in the coming years. This is something that, if I'm a landlord, I'd be thinking about in the context of operating these properties. So looking at this broadly, property owners and managers want to be comfortable that their expenses will be growing at a faster rate than their revenue, obviously, and we do lots of projections where we project out income and expense growth over time. Traditionally, the income limits for tax credit properties have increased slightly faster than operating expenses, although that gap has been small, both have been around 3% annually and a lot of the projections that we run obviously end up showing 3% growth in rents and 3% growth and expenses when you're underwriting for an equity investor. If you're underwriting for a lender or a state agency or something else, you can have different growth rates because they're more focused on the stress testing as opposed to what they think are the more likely outcomes are.

But something that you've done a lot of work on, I thought it would be worth touching base and getting your thoughts, is the Great Recession. And you've done a lot of work around analyzing the effect of the Great Recession on tax credit properties and that was the last time that we saw operating expenses actually growing at a notably higher rate than rents. So what lessons do you take from the Great Recession that maybe we could be applying here?

Comparison to Great Recession

[00:35:56] **Blair Kincer, MAI, CRE:** I think in general it's if you watch the lag in that data process through the Great Recession, I think there's a real difference between the Great Recession and what we're facing now, because the Great Recession happened with the lower inflation issue so that was an aspect of it that's different. But at the beginning of the recovery, right when we felt that the economy was growing out of the recession, you weren't seeing that in the AMI changes because they were that three-year lag. And so you were seeing expenses outpace revenue increases and then as it matured, the increases in real income happened and all of a sudden you saw the revenue started to outpace the expenses a little bit. And as we matured, they started to come back together again. And we saw that properties could in a little bit more robust revenue environment, they could make up for some that they may have put off. They may have put off some repairs and maintenance in more lean years and we saw that being accommodated in the later years. It's kind of funny. It's like, you could watch this ripple through the years, but at the end of the day, it ended up being at 3 and 3 over the 10-year period. So it was kind of one of those things where it was a lot of angst to get to the answer, but it was where we expected.

[00:37:18] **Michael Novogradac, CPA** Right, right. Well, certainly when you do a forecast of 3 and 3, you don't think every year is going to be 3 and 3.

[00:37:23] **Blair Kincer, MAI, CRE:** Right. Exactly.

[00:37:24] **Michael Novogradac, CPA** But it's also something to keep in mind because I think when you look at the more recent years, maybe more significant area median income increases in a lot of areas, folks can look at that and say, boy, you know, incomes and revenues are rising a lot faster than expenses. And you have to, as you point out, think of the longer term, think of the 10 -or 15-year horizon and how there are periods of time where expenses are rising faster than income and when you're looking at it from an underwriting and a policy perspective and you'd be looking at the increases on average over time, not any a given year.

So Blair, thank you very much for sharing your insight. So our listeners certainly can tell by listening to this podcast, you're a great expert in these areas and there's also a lot that we don't know about the inflation rate. If we knew what inflation was going to be, we wouldn’t be doing what we're doing here. So I think the most important thing I think for listeners to take away from this podcast is we don't know what the inflation rate is going to be going forward. It could be a short-term trend or it could be endemic, which obviously makes it difficult to plan, but I think you can't plan on it being a short-term trend, such that you'd be severely damaged if it turned out to be more endemic.

And we do hope that our discussion today does help our listeners start considering how inflation might affect the properties or investments that they own, investments they've made, properties or investments they’re thinking of making and properties in the process of development. I do think you have to run your projections with a greater, more expansive stress testing to take some of these broader variables or potential changes in. So Blair there's going to be some listeners I'm sure that want to reach out to you for more information. So if you could share your email address.

[00:39:10] **Blair Kincer, MAI, CRE:** Blair.Kincer@Novoco.com.

[00:39:24] **Michael Novogradac, CPA** Great. thank you, Blair. Please stay around for our Off-Mike section.

To our listeners. Please be sure to tune into next week's episode of Tax Credit Tuesday as Blair and I have been foreshadowing in the course of this podcast, Blair's going to be back and he's going to discuss how the COVID pandemic has affected investors' and lenders' view of various markets and property types. The pandemic has generated an abundance of unique property- and market-level data that needs to be analyzed and sorted and more important, there's a lot more noise. So investors and lenders are facing greater challenges separating the signals from the data from the noise from the data. And during our podcast, we'll discuss some of the noise that Blair is seeing, as well as ways to identify the signals.

So this podcast next week will be a particular interest to underwriters, of course, but also developers and managers of tax credit properties, that will be dealing with a number of underwriters.

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Off-Mike Section

Now I'm pleased to reach our Off-Mike section, where listeners can get some off-topic advice and words of wisdom from our podcast guests. So Blair, one of my common questions I love to ask guests to the podcast has to do with goal-setting and ways in which the guests set and pursue goals. So I'll ask you, how do you set and pursue goals?

[00:41:35] **Blair Kincer, MAI, CRE:** I saw this and I kind of wondered how I'd answer this because I've never really been a goal setter. We always have our budgets. We always have these goals out in front of us, but I've always been more of an, OK, I have my goal and I want to focus on what do I do daily to impact my goal? So if my goal is to have five new clients by the end of the year, I generally don't think about how to get to those five clients. What I think about is what's the next best thing for me to do this morning if I want to add clients and sometimes that's picking up the phone and calling somebody, sometimes it's hitting a deadline that I already have in front of me. So I generally think about it as almost a daily exercise in today what do I do to be a little more short-term than a long-term in that thought process.

[00:42:14] **Michael Novogradac, CPA** No, I like that. It shows that you're more action oriented. I've got to find the 10 next things I'm going to do and I want to do this one thing that can help me get my goal.

[00:42:23] **Blair Kincer, MAI, CRE:** Exactly.

[00:42:23] **Michael Novogradac, CPA** So, another question I'd like to ask is what type of career advice guests have for someone beginning a career in their field. And obviously we have valuation experts, as well as accountants and the rest as guests of the podcast. So what advice would you give someone beginning in your career?

[00:42:43] **Blair Kincer, MAI, CRE:** Learn. That's one thing that I've really liked about my career is the fact that you approach it with an open mind, you approach the opportunities with an aggressive leaning into the learning aspect of it. You and I have tripped into some business lines just because we were open to what's next. I liked that about this career path and I think that's what I would recommend for anyone is that desire to learn, the desire to be open.

[00:43:12] **Michael Novogradac, CPA** Right. Thank you for that. The last question, we spend a lot of time in the course of this podcast talking about the pandemic and the impacts and next week's podcast we'll be talking about the pandemic and some of the noise it's creating around local markets and how underwriters can sort through and filter out the noise to find the signals. But I was wondering what professional lesson did you learn from the pandemic? And it can't be Zoom related.

[00:43:43] **Blair Kincer, MAI, CRE:** Because I haven't learned anything Zoom related. I'm still messing up Zoom on a daily basis. I'll go back to the pursuing the goals thing. I really, it kind of doubled down on me. It's a daily issue. Learning from the pandemic that I want to focus daily on the simple things, what's next. I don't want to pop my head up and get confused or get distracted by the bigger things that may be beyond my control. I think it's also kind of softened me a little bit made me a little bit more forgiving of myself and of others and be a little bit more patient with myself and others because you can sometimes raise your head up and get a little bit distracted and get a little bit panicked by, oh my gosh, what does this mean? What does that mean? I think we all can feel that. So going back to my first, how I pursue goals, it's on a daily basis and this just reconfirmed that for me.

[00:44:41] **Michael Novogradac, CPA** I really liked the emphasis on the daily basis. You know that you talk about a one-mile run starts with that first step.

[00:44:53] **Blair Kincer, MAI, CRE:** Exactly.

[00:44:54] **Michael Novogradac, CPA** You're a runner, so I guess you apply the way you run to your goals.

[00:44:58] **Blair Kincer, MAI, CRE:** Yeah, you would never run five miles if you felt the way you did in the fifth mile. You always start with that first step.

[00:45:06] **Michael Novogradac, CPA** So thank you again, Blair, and to our listeners. I'm Michael Novogradac. Thanks for listening

Additional Resources

Email

[Blair Kincer]

Washington Wire Column

[Effects of High Inflation on Development, Financing and Operation of Tax Credit-Financed Housing]