Like with all of society, the COVID-19 pandemic had a dramatic effect on tenants and operations at low-income housing tax credit (LIHTC) properties. In this week's episode of Tax Credit Tuesday, Michael Novogradac, CPA, and Novogradac partner Blair Kincer, MAI, CRE, discuss the various ways the pandemic and its economic repercussions affected LIHTC properties. They discuss the overall impact, then look at how occupancy levels were affected, as well as what happened to properties that came online during the pandemic. They then discuss the ability to achieve maximum rents as we emerge from the pandemic, how operating expenses changed during the pandemic, what changes are being made while underwriting proposed LIHTC developments and how underwriters are using the pandemic years to estimate future LIHTC expenditures. They wrap up with a comparison of the effects of the Great Recession to the financial issues coming out of the COVID-19 pandemic.

Summaries of each topic:

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Transcript

[00:00:09] **Michael J. Novogradac, CPA:** Hello, I'm Michael Novogradac. And this is Tax Credit Tuesday. This is the March 8th, 2022 podcast.

This month marks two years of the COVID-19 pandemic and virtually everything in our world has been affected by it. In light of this two-year milestone, on this week's podcast we're going to discuss the effects of the pandemic on underwriting and operating low-income housing tax credit-financed rental housing. Specifically, we're going to discuss how the pandemic has been affecting tenants and the properties in which they live. We're also going to discuss how investors, property managers and underwriters should assess or weigh the various pandemic effects as they develop and finance additional tax credit properties. We're going to discuss the effect of the pandemic on underwriting new developments, because one of the many challenges in developing tax credit-financed housing is estimating future rents and operating expenses and that challenge has been amplified by the pandemic, a time when data has been changing rapidly. I do note that last week Blair Kincer, who is also this week's guest, Blair and I talked about the effect of inflation on financing tax credit properties, developing what the actual development cost of tax credit properties are as well as the effect of inflation and operating expenses and projected future income on such developments.

Now this week's podcast, we're not going to focus on the inflation aspects of the pandemic. And we can leave it to the economists to discuss what impact the pandemic has had on inflation. But I do encourage our listeners to go back and listen to that podcast if you're currently underwriting new developments. Having a sense of the impact of inflation on new developments, both with respect to development costs, development, financing, operating revenue, operating expenses is critical. But this podcast will be focused more on the more observable pandemic-related effects on current properties and the impact of that on future developments.

Now my partner Blair Kincer is based out of one of our off D.C. offices, one of our Washington, D.C.-area offices, and Blair co-leads the company's government consulting and evaluation advisory service group or Go-VAL. As I noted last week, Blair specializes in market analysis and appraisal in a variety of tax incentives and is one of our in-house experts on data and ways to interpret it. Now at Novogradac, we prepare over 2,500 market studies for low-income housing tax credit properties a year, all over the nation and we've done market studies in every U.S. possession. With that experience, Blair and his team have special insight into what we're seeing in markets today and what that could mean for the future. Now there's a lot we want to discuss today. So if you're ready, let's get started.

Blair, welcome back to Tax Credit Tuesday.

[00:03:13] **Blair Kincer, MAI, CRE:** Of course. Thanks for having me again.

[00:03:15] **Michael J. Novogradac, CPA:** Yes. Back to back. I think you might be the first back-to-back. I might've done it with Peter Lawrence in the past, dealing with Washington D.C.-related matters when things are changing rapidly.

[00:03:26] **Blair Kincer, MAI, CRE:** I can't compete with him so nice to have the distinction that I'm the second person.

Broad overview of pandemic effects

[00:03:32] **Michael J. Novogradac, CPA:** There you go. Let's start at a high level. We're two years into this pandemic and I don't know when the pandemic is going to be viewed as an endemic, but there's been a lot written and spoken about COVID-19 and the impact it's had on low-income housing tax credit properties. Obviously, we've covered that a lot in the Journal of Tax Credits that Novogradac publishes, in prior podcasts, on our website, at our conferences and the like. But I thought we could start it, maybe you could just share, this is a very broad overview, some of the major areas where you've seen the pandemic have a notable or more discernible effect.

[00:04:12] **Blair Kincer, MAI, CRE:** Well, thanks, Mike. And the way I will step into the question is I think back to when the pandemic started and my first concept was OK, how's this going to be like and how this is going to be different from the other recessions, the other economic shocks that we've seen? And I immediately thought, OK, so occupancy rates are going to drop, occupancy rates have dropped in previous economic difficulty, so they're going to drop this time. And for various reasons, occupancy held very strong during the pandemic and we'll talk a little bit more in detail about that as we go forward, but that was a little bit of a surprise to me. The other part of that occupancy holding strong was the lack of turnover. There was simply just less turnover as people wanted and did stay in place and were encouraged to stay in place. We did see turnover periods becoming longer because if a property did experience a vacancy, it was more difficult to turn the unit. It was more difficult to get that unit leased. We also saw that with new properties. I think the third thing when I think of the top line of the occupancy and the vacancy, is the bad debt levels. Obviously, there was significantly more bad debt. Again, I expected that, but what I didn't expect is the amount of subsidy, the amount of rent support that we were able to focus on individuals and properties that was able to offset that bad debt.

So that was the first high-level thing that I noticed at the beginning, or kind of looked forward to. I think the second thing that immediately became apparent was the amount of variance that we were seeing in rental rates. Obviously, we had a lot of properties not increasing rent, both based off of local jurisdictions' moratoriums and also based on property managers and property owners choosing not to increase rents. As the pandemic unfolded though, those things changed a little bit from many properties. We also saw new properties being built. But what we saw was a dramatic increase in the variance of rent. Some properties would be not even close to getting max while other properties were getting max and that causes us some confusion and some concern and we've been addressing that in our market studies because we hear questions about that, because that seems to be the question that most of our clients want to know. As we know, that max rent is set by HUD, based on the AMI for the tax credit properties, but achievable rent is set by the market. Prior to the COVID pandemic, we saw that the run-up after the Great Recession, we were seeing more and more markets at max. It was becoming a truism that most markets, and I think that's a pretty fair statement, that most markets were at max prior to the pandemic and that was a significant change from the Great Recession 10 years prior. I think that there was a lot of reasons for that and then the COVID happened and variance settled in. I think that variance is caused by a lot of uncertainty. The property managers themselves feeling uncertain about what they can charge tomorrow. I think it's caused by a lot of additions to supply in an uncertain market, while the occupancy was certain, the rent felt more uncertain.

And I think the final thing that contributed to that uncertainty is employment. We saw unemployment rates go up dramatically. Now we've also seen, as the pandemic has matured, employment growth be significant and we're all seeing, again, I mentioned it last week, I mentioned it this week, the signs with McDonald's begging for employees. We see that and there is strong employment growth, but what we also saw was a giant churn in employment. Some jobs are coming back less robustly, some jobs are coming back very robustly and that churn has caused property managers and tenants to experience some uncertainty about employment and about rents.

I think the final area that I wanted to talk about is the operating expenses. I think, obviously, maybe not so obviously, but in the beginning of this, we all kind of talked that repairs and maintenance are going to be the one area that we're going to see a dramatic impact because of COVID and to be clear, we did see repairs and maintenance go down in 2020. That was, it's very clear when we look at a same-property analysis that repairs and maintenance did drop. However, I was surprised it didn't drop as much as I expected. One of the things that I get to do is walk properties. I walk three properties a week, possibly on average, and sometimes I'm getting to walk with the property manager. Sometimes I get to walk with a maintenance individual. What I realized and we talked a little bit about this in the inflation is when you talk to the maintenance person, they talk about stuff. They talk about the price of a compressor for a refrigerator or for an HVAC unit. That stuff went up in price dramatically because of supply chain issues. They don't talk as much about services, which may have lagged in cost increases. And so when I would say to them, “Hey, I expected to see less spent on repairs and maintenance,” the first thing they would say is something funny, like, “Yeah, well, there's always something to fix. No matter if you're in a unit or if you're out of a unit, there's always something to fix.” And then they would say, “Yeah, but everything's so much more expensive now.” Utilities, they went up across the board. Interesting fact that I found was actually senior properties went up greater than family properties. I'm still trying to pull that one apart. I'm talking to property managers and getting all sorts of silly reasons why that could be true. I haven't really landed my landed on what I think caused that, it might just be a quirk of data. So those are the three big areas that I think were impacted by this dramatic change in our economy.

Pandemic and LIHTC occupancy levels

[00:10:11] **Michael J. Novogradac, CPA:** I liked that breakout into basically occupancy levels being high and the fact that the rents that many properties were achieving were below the maximum allowable rent. And you note that wasn't the case predominantly before the pandemic, but became a pandemic-related observation. And then you also touched upon operating expenses and some of the impacts the pandemic has had on operating expenses. Maybe we can unpack each of those a little bit more.

Let's start with the same order that you presented them. We can start with occupancy levels because I similarly was concerned about occupancy levels and even wrote a column in the Washington Wire with Todd Crowe from PNC addressing some of our concerns about the occupancy levels, both physical occupancy and effective rent collected. So maybe you could share a little bit more insights in terms of maybe over the course of the pandemic, how occupancy levels maybe changed, maybe if there are different types of properties or different areas of the country that you saw different distinctions. What more would you say that you observed with all the market studies that you were working on in as a consequence of doing market studies and try to project future income and expenses and the like, doing surveys to assess what current occupancy levels are? What more data would you share?

[00:11:46] **Blair Kincer, MAI, CRE:** Sure. I think the question about the property types is really quite interesting, because it does vary by property type, but it also even within the tax credit properties, it varies by location when we talk about where the tenants predominantly work. We saw that if you were in a tourism market, let's pretend that Orlando, let's think Las Vegas, there is significant unemployment in those locations. A lot of those jobs have yet to come back and so you still have that and you can see that in the labor participation rates. Now the last recession we saw labor participation rate decrease and that was obvious. It started going back up as the recovery matured. Wow, did it really take a shot with COVID and a lot of economists are talking about why that happened and I think one of the obvious reasons is a lot of people were afraid to go back to work, a lot of people didn't feel safe. So I think that really harmed labor participation rates, but I think also we see that at the property level. I talk to property managers, who say, “yeah, 20% of my tenants still aren't back to work.” So it's not so much in, and of course that's unemployment, now, some of the unemployment benefits are burning off but that is now being more clearly illustrated in labor participation rates.

Now I think that it's going to be interesting, not going back to the inflation discussion, but I think it's going to be interesting as labor participation increases. Does that increase in supply of labor impact some of the wage growth that we've seen? Does McDonald's stop hanging signs advertising $20 an hour when maybe more people are back to work? I think that's going to be interesting to watch unfold. So I think it does vary by property and by property type. I think the other thing to think about or I've been thinking about, is, again, economics is the study of how people behave in a financial world. And I see property managers tell me that well, now that I can evict and not that they were excited to evict, nobody wants to do that, but they've had some forced evictions that have happened. They're still nervous about, OK, so unfortunately, I had to evict a couple of tenants, but I don't want to increase my rents much above what they were paying because I'm not quite sure yet what the market looks like.

One of the favorite stories that one of my longstanding clients tells is that he says, I can't convince my property managers to run a property at 95% occupancy. He said all my property managers want to be at 100% occupancy and he said, I wonder, do we leave our fiduciary responsibility to the property behind sometimes when we accept less rent for full occupancy? I had that conversation with him over the past 20 years, had it again four months ago and he pointed to that and as why there might be a really strong occupancy, but yet some other characteristics.

Properties that came online during the pandemic

[00:14:49] **Michael J. Novogradac, CPA:** Next, I wanted to touch base on the sort of max rents versus achieved rent and the rest. But before we do that, I did want to on this obviously levels, how about for properties that were coming online during the pandemic and leasing up?

[00:15:03] **Blair Kincer, MAI, CRE:** What we saw there was a very geographic variant impact that issue. I probably didn't say that very well, but it was very geographically specific. We saw that properties in places like D.C., where you had significant levels of restrictions and you had significant problems with the infection rates, that you did see a significant slowdown in additions, but also in the ability for a property to do that initial leasing.

That was geographically diverse, it was also based very much so 2020 was very different than 2021. We learned as an industry how to lease units. We learned as an industry how to socially distance, how to get a property. And so at first, what seemed to be a significant lag in leasing units on new properties virtually went away. Now let's be clear demand was there, too. So at the same time that we're learning to do things better and learning to be a more efficient, the demand is just off the charts. And so you saw that. Going back to my geographic point, some parts of the country did not experience a significant effect from restrictions. Their construction crews were able to remain in place and they were able to stay effective. So we didn't see that dramatic of an impact in some locations, but where we did, that impact has pretty much dissolved at this point.

Maximum rents vs. allowable rents

[00:16:35] **Michael J. Novogradac, CPA:** So let's now turn to the maximum allowable rents as set by HUD versus the achieved property rents. And you were noting that many properties were operating below the maximum allowable rents. And maybe you could share additional thoughts as to what was driving that delta, because I know that's one of the questions I get the most from clients is asking me what other clients are experiencing, because they're experiencing a reasonable delta there.

[00:17:11] **Blair Kincer, MAI, CRE:** Yeah. So it's important to remember the formula for AMI and the fact that the AMI is calculated annually, but it's based on the American Community Services data that's three years old. So when we got a new AMI in April of 2020, that was based on 2017 data. And 2021 was based on 2018 data. 2022, where we are today, is going to be based on 2019 data. And so, similar to the last recession, the Great Recession, there was that lag. And so while we were in a state of uncertainty in 2020 and in 2021 and we're all looking around and thinking about the economy, the AMI's going up, because it's based on old data. And so we might've been sitting there in 2020 saying we're not going to increase rents because of some moratoriums or we're not going to increase rents because we feel that's not the right thing to do today. AMI didn't care. The AMI just kept chugging and so you had that kind of a split in what you could charge and what you were charging. Again, going back to, I think there was also and there still is some confusion in the market, not confusion about what is the max rent, but what is, what can I achieve?

You see less of that confusion, interestingly, when a new property opens up. There's plenty of demand. They don't have to look to current tenants to charge max rents. They can simply start from the scratch or start from the day it opens charging max rents. And so that's one of the things that I'm wrestling with clients is wait a minute, the property across the street clearly isn't charging max rents, but this property, brand new, is charging max rents they're not that different. And it's because of that sensitivity to current tenants, again going back to the last week's conversation that we are going to see the inflation start to impact the 2022 max rent level. Our projections, as you know, Mike, are that we are going to see significant increases in the 2022 AMI. My clients know that, my clients are saying to me, "Blair, you keep telling us that such and such market is going to go up 8%, 9%, and sometimes even much higher." I'm not going to say a number because my client might expect to see them, but much higher than what we've seen in the past.

And they, there's no way we're going to get that. There's no way we're going to get that in Parkersburg West Virginia. There's no way we're going to get that in Cumberland, Maine. And I have to say, it's going to become interesting again, when all of these markets that were once at max are no longer at max. And I think that's something that clients are aware of and are really paying attention to when we are doing market studies.

[00:19:54] **Michael J. Novogradac, CPA:** So I think it's a good point that you emphasized with respect to the max income and rent levels that are determined by HUD. They are based upon three-year old area median income data that is then adjusted upward by inflation estimates. So as you point out, when you look at the 2021 rent levels, it's really reflecting the '18 increase in median incomes over '17, adjusted upwards by inflation. So it doesn't, you didn't really see any of the impacts on family income levels during the actual pandemic and all the impacts it was having in terms of unemployment and the like and as those that listened to last week's podcast, or now maybe are encouraged to listen to last week's podcast, we did talk a bit about how all that works and the fact that the 2020 data has some challenges and that we don't expect an ACS data for 2020, which means in 2023, the estimates are going to be it's unclear us how those estimates will be determined. We did mention on last week's podcasts that my partner Thomas Stagg is running an income limits working group to try to help make some suggestions to HUD as to different ways to approach developing the income limits for 2023. But listen to that podcast, reach out to my partner Thomas Stagg if you want to know more.

So, let's talk now about operating expenses and you talked a bit about the impact of the pandemic on operating expenses and you did note that you were initially thinking repairs and maintenance might go down, but they didn't really go down all that much. And in part, because there's lots of work to do outside. Typically you couldn't get into units, with much ease, but there was a lot of work to be done on the outside of the property. Then you also noted that just the cost: you might have done less, but it cost the same because of the cost of goods going up. But what are some of the other takeaways or, either surprises that you weren't expecting to see that there was in any kind of operating expenses or what you thought the pandemic would have and you were right in that expectation.

Operating expenses during the pandemic

[00:22:10] **Blair Kincer, MAI, CRE:** Well, I think it goes back to the split between stuff and services. I expected stuff to go up in prices and I'm actually reading more and more about this, that's one of the things that's affecting our topic from last week is a difference between stuff and services and stuff and employment. There's certainly a lag that we're seeing right now in wage growth versus inflation and that lag is also showing up in property managers on their payroll estimates. I spoke to a client just recently, as a matter of fact he called me after listening to the podcast last week. And he's like, I want to talk to you about payroll and he started talking about it and he said, we're budgeting a 15% increase in payroll for next year and that surprised me. It shocked me. And I said, oh my gosh, that's a lot. That's going to really impact your bottom line. He's like, well, we think that we've had some efficiencies. We think that we can make to our payroll. It's going to go up, but it's not going to go up as much because we're going to try to take our employees per unit from 80 to a 100. He said, if you would do that math real quick, you'll see, I can pay everybody 15% more if I can increase the number of units they're working on. He said, "now it's not going to be perfect. It's not going to be a one-for-one offset, but it will allow me to pay people what the market will bear, but also take advantage of some efficiencies." And we talked about that in the occupancy discussion that there have been these efficiencies.

[00:23:42] **Michael J. Novogradac, CPA:** Efficiencies developed by the pandemic. Or induced by the pandemic.

[00:23:47] **Blair Kincer, MAI, CRE:** Right. Exactly. So I found that very interesting and I go back to some other categories and I think there's so much, it's a multi-variable equation and there's so many things impacting what we spend to operate a property that, it's not, oh, everything's going up so the costs are going up. Some costs are going up, but we're also getting smarter every day.

Effect on underwriting new LIHTC developments

[00:24:11] **Michael J. Novogradac, CPA:** So now we've talked a lot so far about what you've sort of observed during the pandemic with respect to occupancy levels, maximum rents versus achieved rents and operating expenses. Now I'd like to ask you questions about the impact these pandemic-observed events have on underwriting new developments. Let's start with occupancy levels, bad debt and the like. When you're talking to clients developing new properties and they're developing their projections, what's your advice to them in terms of what aspects of what we've been observing during the pandemic is it going to continue versus aspects of those assumptions that you'd look at and say, OK, that I expect to be different on a new property as opposed to an existing property. And I emphasize that just because you think, well, that's true every year, but after the Great Recession, you had to take all this stuff that happened in the Great Recession and say, OK, now we're outside of the Great Recession what was happening there is probably not going to be happening for a while again.

Well now, you're in that same situation with the pandemic, you can't say, well, it's going to be the same as it was a year ago or two years ago, because it was such an extreme event.

[00:25:23] **Blair Kincer, MAI, CRE:** I think the question is really good because I think you're looking back at the Great Recession. One of the things that came out of the Great Recession is going into the Great Recession, there was a lot of talk from underwriters, the 5% vacancy that everybody underwrites, can we be at 3%? Can we be at 4%? Can we be at 2% given the subsidy on the property? And so there was that conversation. After the Great Recession, boy, everybody jumped on 5%. That was now, that was the right answer. And that was because we did see an increase in vacancy coming out of the Great Recession. So going into this situation, I expected to have conversations, OK, now we're going to use 3% on his property because we think it's the right number and I expected some pushback from underwriters, but we didn't see that. And I think it was a realization that, wow, this really did not impact occupancy. Now, do we have to think about it in other ways? Of course we do.

But that was one area in terms of occupancy that looking forward, I don't think we're going to have that knee-jerk reaction of, oh, it's going to be 5% on all properties or maybe even 7%. I haven't seen that. And I don't expect to see that.

[00:26:33] **Michael J. Novogradac, CPA:** And then how about the max rents? You touched upon how with a new development, you could be achieving max rents as you're leasing it up, for a variety of reasons where you might be leasing it up next door to a property that isn't at a max rent. So your market study, when you survey a community, you might find that most properties aren't at max rents, but a new property under development should be able to achieve max rents. What's your thoughts on that front?

[00:27:00] **Blair Kincer, MAI, CRE:** I think that makes our job more difficult. Not that I don't want a difficult job, but I think we have to be very leaning, we have to lean forward into this question. We have to make sure that we come up with good arguments as to why we believe this property, if we believe that, why we believe that.

And the three areas that we are typically leaning more on today than we were yesterday or five years ago is that market rent advantage. It's always in our reports, it's always been discussed, but I think we're looking at it a little bit more aggressively. We're making sure we lean on that point a little bit more because market-rate properties are far more elastic than a tax credit property. They have a higher turnover rate in general, so they're churning units much more rapidly than a tax credit property. And so I think that elasticism allows us to use them as a comparison point and we can talk it, we can speak out loud. Do we want that differential to be 10%, 20% or 30%? that's fine, but having that discussion I think is very important.

I think the second thing that we've been really focused on is talking to property managers and not just saying, "Hey, you're not at max. Oh, well." Asking them, "OK, let's pretend that, you could get whatever rent you thought was, that you could, what do you think it could be if you were empty and you were trying to lease to brand new tenants, what do you think you could do?" We tried to play the let's-pretend game with the property managers and generally you do 10 interviews and you walk in and you smile a lot. You can get one or two to talk to you and kind of hypothesize like that. And sometimes it's not really great data because it's so anecdotal and it's so conversational, but sometimes you get some really well thought out conversations and I think that's helpful.

I think the last thing that we've been relying on is being a little bit more broad when we talk about comparable research. We've always been, hey, you want the closest and most similar properties. And I think that's true today as it was yesterday. I think there's a corollary to that, you know what, I wouldn't mind just finding a new property somewhere. I'm not quite sure it needs to be within 2 miles. I'm not quite sure it needs to be within 5 miles. Just let's find a new property, throw it in there and see what it does to our dataset. So we're being a little bit more generous when we say, OK, we have five great comps though and another one might not be close by, but let's see what it tells us.

[00:29:23] **Michael J. Novogradac, CPA:** That's an interesting point about the whole comparable, because there's no perfect comp. Some comps are good in some ways and not as good in others and there's lots of almost metaphysical discussions you can have about, what's comparable. One other thing I'd maybe unpack a little bit and it, actually, is the question I'm about to ask is in some ways that drove Novogradac to be doing market studies in the first place. Which has to do with, in your thinking about low-income housing tax credit property and we talk about the max rent that can be charged in a given area and you have to know what market rents are because obviously, there's restrictions on the rent levels and you have to assess where the rent is relative to market rents. And you talked about 10%, 20%, some level below kind of market rents for a comparable unit. Use that comparable word again. But there's also the issue about income level and the number of families in a given area that have high enough income levels to afford those rents but not such a high income level that they're not qualified for those units. You have that qualifying band, if you will, of income. Obviously, I'm talking about families that are on Section 8 or seniors that are retired and getting Social Security and all the rest, but you have to identify that band of tenants. When you think about the pandemic, which was the more–because I think it was somewhat interactive, how do you think that the pandemic has affected that calculus and how that calculus might be affecting underwriting current properties?

[00:31:08] **Blair Kincer, MAI, CRE:** That's a real difficult question, Mike, I'll be honest. I'll be honest with you because it is something that I'm in process trying to run that through my noggin. I think it's definitely something Thomas Stagg and I have actually talked about this a lot in terms of AMI's median. And that's one family, somewhere in whatever jurisdiction you're in. We definitely see markets where the majority of the tenants living in low-income housing tax credit properties do not look like 60% of the median income. They may be earning significantly less. We see that in a lot of tourism markets. Interestingly enough, we also see that in markets, let's suggest Cheyenne, Wyoming. Cheyenne, Wyoming is a capital, it has a military base nearby, I forget the name. They actually have a pretty high AMI, pretty high median income. Most of the tax credit tenants living in properties there are not close to that 60% AMI level because of the type of job employment.

Now your question was OK, so COVID and its impact on it. Well, I think going back to my point about entertainment jobs. Entertainment jobs have not been coming back as quickly as others. I think another thing that's interesting is the geography of the low-income housing tax credit tenant. They are relatively inelastic in terms of location. In other words, because most essential workers cannot work from home, many properties have a large share of essential workers, so they necessarily cannot modify their location based on maybe finding better rent somewhere else. Because in the D.C. metropolitan area, that means your adding an hour to your commute. I'm sure that's true in many locations.

And so it's becomes, yes, some entertainment properties have a lot of people who are not yet employed. And maybe when they go back to being employed, maybe there'll be less entertainment jobs. Maybe there'll be the same amount. We don't know that yet. Some essential workers are, I don't want to use the word trapped, but they are in a difficult position where they have to go to work. They need to go to work. They want to go to work. They don't want to have an hour-and-a-half commute, so I think that creates a different situation in terms of employment and staying in place. So I think that there have been some impacts and there is going to be continued filtering through the process of impacts or effects on the tenancy of a tax credit property.

The final point I'll make is this churn of people changing jobs. No matter when you change a job, no matter what kind of job you're changing from, it's not always the easiest process and if once you were a retail worker and now you're going to be a driver, for some people that may not be as an easy change for others.

Using pandemic years to estimate future expenses

[00:33:58] **Michael J. Novogradac, CPA:** Thank you for that. And I realize it's a really challenging question. I've been known for asking them once or twice on the podcast, but I just wanted to sort of just highlight or maybe emphasize that whole point about in addition to looking at the market or where the market rents are or the rest, looking at what the income levels are, how high they have to be to support certain rent levels. And the fact that as you point out it's median income levels and you don't know how close they're banded to that higher end versus the lower end, if you will. So those are challenging issues and, in some markets, it's not as challenging as others. So you've done a good job in the course of the podcast emphasizing how specific this is. And I'm sure every trend that we're talking about here, whatever general observation, you got examples where they cut against that market study and you have to explain why in that particular situation, it was opposite that and as you're doing a market study for particular property, you're not dealing in averages across the country, you're dealing with that properties are doing, even though, here we're talking more about general observations or lumpiness, if you will. So let's turn to operating expenses and what, when you look at the experiences during the pandemic, what extent do you think that's informing estimates of future operating expenses and operating expense costs of different or different categories of operating expenses?

[00:35:29] **Blair Kincer, MAI, CRE:** Sure. I think going back to our point about last week, inflation is affecting everything differently. I am a little surprised that, we are definitely utilizing 2020 and 2021 very heavily. I don't have underwriters telling me, "Oh, we can't look at those years because they were so different." Again, going back to my point that fundamentally they weren't as different as we expected. So I think most underwriters are saying recency is very important. They really want recent data. I think that's something that has become very clear to me. I think the other thing is again, looking at individual items specifically, real estate taxes are going to grow are going to change differently than utilities. Understanding those differences.

[00:36:13] **Michael J. Novogradac, CPA:** Would you agree that the impact of inflation is so significant on estimated future operating expenses that whatever might've been distilled or it might've been different operating expenses because of the pandemic is dwarfed by the impact inflation will have?

[00:36:31] **Blair Kincer, MAI, CRE:** Without a doubt. Again, you opened with is inflation a product of the pandemic? But itself as a bear is worth considering and thinking about.

Great Recession vs. pandemic

[00:36:44] **Michael J. Novogradac, CPA:** So I did mention the Great Recession and you've done a lot of work analyzing the Great Recession and how properties preformed during the Great Recession, the impact coming out of the Great Recession and the like. So I want to give you an open-ended question: Basically, what lessons were learned or observations were learned from the Great Recession that would be applicable in a pandemic to endemic world, or maybe lessons that we need to unlearn from the Great Recession, dealing with where we are now.

[00:37:19] **Blair Kincer, MAI, CRE:** I like this question and I've been thinking about it because I actually had it asked a little bit differently on a presentation that I was giving. So I've created this structure in my head of three similarities and three differences and ticking through those.

Employment. The first is a similar: entertainment was first and hardest effected. In the Great Recession, we saw Las Vegas be dramatically impacted in terms of occupancy and in this situation, we're seeing entertainment being dramatically affected. Now a difference about employment. It's the stability of essential workers. This definitely had a far more stabilizing impact on some families, that they did work through the pandemic, that they were appreciated, that they may have seen significant or inflationary wage increases during the pandemic. We did not see that during the Great Recession. There was not that kind of stability in some of the employment areas.

Another one, similarly, the economic shock of the Great Recession created new opportunities and new challenges. Old jobs disappeared in the Great Recession, new jobs became apparent. That kind of turmoil, that kind of churning of jobs happened in the Great Recession. It happened in this recession as well. That's something that's very similar. We've seen that churn. We talk to property managers and they talk about their tenants changing positions, changing careers, if you will. The difference was the pace of that change happened very dramatically in this recession. The amount of job growth that has happened immediately following is the much more steep of a curve than it was in the Great Recession. And I think that there could be lots of reasons and I think we'll unpack those reasons as we unfold.

I think the fact that it's a pandemic versus a financial crisis might be the key issue.

I think the one final point would be the similarities that the economic turmoil always impacts individuals and individual families in different ways and the closer you are to that margin, the more vulnerable, the harder it's going to be on those families. That's very similar. That recession in 2008 and this one now. I think that is something that kind of drives what we do for a living. We want to make sure that we're trying to address those inequities as much as we can. The lack of inflation in the Great Recession and the inflation and wage growth that we're seeing now, we see this significant wage growth. Again, the McDonald's signs. I'm hoping this is a long-term thing that wages for the bottom cohorts can continue to grow at near inflation rates or near the general wage growth. We did not see that in the Great Recession. The inflation was not discussed. Wage growth was not as apparent as it is here.

[00:40:06] **Michael J. Novogradac, CPA:** Well, that's all very interesting. And there's so many more questions I want to ask you. There's a lot of threads I want to pull.

[00:40:14] **Blair Kincer, MAI, CRE:** If you pull some of them, my arguments will completely fall apart.

[00:40:18] **Michael J. Novogradac, CPA:** I don't know about that, but there's lots to talk about. I'd love to be chatting with you more. I really appreciate you sharing your insight on today's podcast. This has been a really educational for me and I'm sure it's been educational for a large number of listeners, and I'm sure some of the listeners are going to want to reach out to you directly as some of the clients already have from last week's podcasts. And non-clients. So if you could please share your email address, so clients know where to reach you through email.

[00:40:49] **Blair Kincer, MAI, CRE:** Sure Blair.Kincer@Novoco.com.

[00:41:05] **Michael J. Novogradac, CPA:** Great. Thank you very much, Blair.

To our listeners, please be sure to tune into next week's episode of Tax Credit Tuesday. My partner, Alvin Lee, from our San Francisco office, will be the guest and we will discuss how generally accepted accounting principles affect renewable energy tax incentive negotiations and structures.

Renewable energy transactions have a greater diversity of legal structures than other community development tax incentives. There are pass-through leases, back-leverage partnership flips, puts, calls and more. This greater diversity of legal structures not so surprisingly leads for a greater number of financial accounting considerations, with many investors being publicly traded corporations and/or otherwise quite sensitive to financial reporting of their investments, the issue of GAAP, or generally accepted accounting principles and how they influence the financial reporting improvement of your transactions, is a critical topic for any transaction that's being structured in the renewable energy area. As such, understanding the financial reporting implications of various legal structures is very important for both developers and investors to be aware of. It's critical to select the optimal structure to raise the most equity capital for a given transaction. It's also important to avoid unpleasant surprises after the transaction closed. So please tune into that podcast.

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Off-Mike Section

So 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, I appreciate you joining me for this bonus part of the podcast and I thought I would start just by asking you what part of your job do you enjoy the most? And that's beyond being on a podcast with me.

[00:43:26] **Blair Kincer, MAI, CRE:** Of course. But what I like most is very similar to this conversation. What I like is you take the data that we see, that we get in our reports, that we have in our database and then you'll walk a property with the property manager, you walk a property with a repair guy and you start having conversations and you start either A. questioning the data that you've read, or you start saying B. well, yeah, I can see how that anecdotal matches the data. I really love that juxtaposition. I really love that the real walking a property and seeing things and then taking it back and looking at the data. So that's kind of like this podcast, talking about what we see in the marketplace and comparing it to the data that sometimes is supportive and sometimes is confounding.

[00:44:11] **Michael J. Novogradac, CPA:** No, it's the same for me. I really enjoy the opportunity to look at lots of data, lots of stories, lots of anecdotes and then try to take a cumulation of anecdotes and try to reduce them or distill them into lessons we can learn all the while knowing that by reducing or distilling, you're losing some of the robustness and having to constantly double check that and see how maybe you reduce it too much, or did I weigh things the right way. So all that change is very enjoyable.

So the other question I'll ask you, then I'll let you run, has to do with leadership lessons. And if there's maybe a No. 1 leadership lesson that you've learned, either someone else taught you or you distilled it yourself. It's hard to say there's a best one, but a very good one.

[00:45:07] **Blair Kincer, MAI, CRE:** The one that I repeat to my kids is being authentic. Early in my career, I taught this myself because I heard myself sometimes trying to rally the troops or trying to effectuate change and maybe I didn't really fully believe what I was saying. And I heard myself and I heard it sound off tone. I did that probably for a period of time and I just stopped. I said, "No, if I don't believe in it, I'm just going to be silent. I'm going really try to lead from stuff I truly believe. I believe in A, B or C whatever. If I don't believe in D, we'll move on to E." I found that, whether I don't know that anybody ever really heard it as hard as I heard it, or it sounded as off tone as I heard it, but boy, it bothered me at times. So that was the one thing that I taught myself was just try to be authentic, try to be yourself and sometimes that's going to be a little bit weird, a little bit silly, but just, stay there and we'll see what happens.

[00:46:08] **Michael J. Novogradac, CPA:** I like the authenticity. That's a pretty critical and it's also one of those leadership lessons that it's a lot of times when people think of leadership lessons, it's all about you doing something to affect others, as opposed to the whole authenticity is more of leading by example and sort of saying be authentic. Which always reminds me of the old phrase that many people use. There's a lot of things you say that you don't really think about and gets to be common parlance. And a lot of times people will say, well, let me be honest with you. And you say that not thinking, "Wait. You were not being honest before?" They're trying to emphasize what want to focus on, but it does leave that implication that you weren't being honest with me before? So I think about your authenticity and the rest, I also think about how words sort of matter and trying to be careful not to fall into some of those old tried and true. I'm not sure about true, but common phrases that when you sit back and unpack it a bit, you're like, well, that's probably not the thing I should be saying. And ironically, it's a lot of politicians that you hear say that, of all people should not be using a phrase like that.

But so anyway, thank you again, Blair for joining us. And to our listeners, Mike Novogradac. Thanks for listening.

Additional Resources

Email

Blair Kincer