A CohnReznick Webinar

THE LOW-INCOME HOUSING TAX CREDIT PROGRAM AT YEAR 30: A PERFORMANCE UPDATE

Tax Credit Investment Services
January 21, 2016
About Us

CohnReznick LLP is a national accounting, tax, and advisory firm proudly serving a number of diverse industries including Affordable Housing, the firm's largest industry practice.

Tax Credit Investment Services ("TCIS") is a dedicated business unit within CohnReznick that provides strategic advisory and due diligence services to help clients make informed decisions on acquiring and managing tax-advantaged investments.

Our core services include:
- Tax credit and CRA investment strategies
- Investment due diligence
- Portfolio reviews
- Organizational assessment and process improvement
- Market education and industry research
Agenda

Study background

Property Operating Performance

Fund investment Performance

Key takeaways
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Key takeaways
Housing Tax Credit Time Machine

Late 1980s

- $1B equity market
- $0.40/$1 credit
- Equity sourced from individuals

1993

- Corporate market developed
- Equity sourced from “C” corps

2000

- $4B equity market
- $0.60/$1 credit
- 10% IRR

2006

- $9B equity market
- $1.00/$1 credit
- 4.5% IRR

2008-2009

- Market meltdown
- HERA saved the day with TCAP and Exchange programs

2010

- Market rebound

2014

- $12.5B equity market
- $0.91/$1 credit
- Equity sourced 85% from commercial banks (50% from top five banks)
Investor Motivations

- Favorable risk-adjusted return
- Positive consideration under the Community Reinvestment Act
- Tool to manage the company’s effective tax rate
- Corporate social responsibility / public relations
- Cross-selling opportunities
Origin of Our Performance Studies

• So... You want to see the track record?

• The first study was undertaken by CohnReznick professionals in 2000 when 6,250 properties were surveyed.
The Current Study

- Over **20,000 properties** surveyed in 2015; representing approximately **70%** of “actively managed” LIHTC properties and $83 billion in total credits.

- 50 U.S. states, Guam, Puerto Rico, and U.S. Virgin Islands

- 92% of U.S. MSAs

- Data contributed by **35 participants** including every active LIHTC syndicator.
Portfolio Composition (% of net equity)

By Availability of Rental Assistance
- Yes: 66.1%
- No: 33.9%

By Availability of Property Tax Relief
- Full: 61.1%
- Partial: 18.6%
- None: 20.3%

By Fund Type
- Multi-investor: 60.9%
- Proprietary: 31.5%
- Guaranteed: 7.6%
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Key takeaways
High occupancy continued
- Occupancy levels in LIHTC properties have been remarkably consistent from one year to the next.
**Occupancy Performance**

- **Economic vacancy losses decreased**
  - The spread between physical and economic occupancy has decreased to just 90 basis points.
  - Strong demand for affordable housing units has lowered the turnover rate/costs in LIHTC properties, minimized the use of concessions, and lowered the loss in rental income associated with rent skips.
  - Property managers are more effective in screening tenants, enforcing rent collections and turning over offline units, compared to prior years.
Cash Flow Performance

- **Improved cash flow performance sustained**
  - Debt Coverage Ratios ("DCRs") hovered between 1.13 and 1.15 for a significant portion of the last decade, before rising to 1.21 in 2009.
  - 2010 marked the first year when none of the states operated below 1.00 DCR.
  - Strong financial performance was observed across every segment and nearly every participant’s portfolio.
2014 Median DCR by State

- 1.00 and below
- 1.01 to 1.10
- 1.11 to 1.20
- 1.21 to 1.30
- 1.31 and above
What made the improved operating performance possible?

Out of many possible explanations, key contributing factors included:

- Unprecedented demand for affordable housing units
- Reduced economic vacancy losses
- More sophisticated expense underwriting
  - A data provider reported a portfolio-wide actual vs. projected operating expense variance of 9% in 2014, vs. 32% in 2004.
- More favorable debt to equity mix
  - The average hard debt leverage ratio among 9% properties was 15% for those closed within the last five years vs. 33% for those closed in the late 1990s
- Refinancing at lower interest rates

Will favorable operating performance sustain?
Operating Underperformance

- Housing tax credit properties are, by design, underwritten with a narrow margin for error due primarily to –
  - rent restrictions
  - the financial feasibility consideration, as the state housing credit agencies are required to allocate just enough credits to make the project financially feasible.

- So... housing credit properties can easily get into trouble when:
  - Operating expenses such as utilities and real estate taxes spike
  - When rents can't be raised due to negative AMI growth
  - When developers over-leverage their projects
  - When crime and drug activity plague the property
  - When replacement reserves aren’t funded and maintenance is deferred.

- Beyond operational risks, housing tax credit properties must conform to statutory and compliance requirements.
Operating Underperformance

- Incidence of underperformance continues to decline
  - 2005 – roughly 35% operating below breakeven (less than 1.00 DCR)
  - 2014 – only 16.9% operating below breakeven and the majority of those only by relatively modest amounts
Cumulative Foreclosure Rate

Rate by Equity: 
Rate by Number of Properties:

Annual LIHTC Foreclosure Rate vs. Conventional Multifamily

LIHTC Foreclosure Ratio vs. FDIC Insured Multifamily Delinquency Ratio

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Cumulative Foreclosure Rate by Credit Type

Year:
- 2000
- 2001
- 2002
- 2003
- 2004
- 2005
- 2006
- 2007
- 2008
- 2009
- 2010
- 2011
- 2012
- 2013
- 2014

Rate:
- 4% rate
- 9% rate
Incidence of Foreclosure by Leverage Ratio

<table>
<thead>
<tr>
<th>Hard Debt Leverage Ratio</th>
<th>Number of Foreclosures</th>
</tr>
</thead>
<tbody>
<tr>
<td>0%-15%</td>
<td>10</td>
</tr>
<tr>
<td>16%-30%</td>
<td>20</td>
</tr>
<tr>
<td>31%-45%</td>
<td>25</td>
</tr>
<tr>
<td>46%-60%</td>
<td>25</td>
</tr>
<tr>
<td>61%+</td>
<td>25</td>
</tr>
</tbody>
</table>
Reasons Cited for Foreclosure

- 25.0% Soft market condition
- 11.5% Non-performing general partner
- 10.4% Operating deficiencies
- 15.6% Debt Default
- 5.2% Ineffective property management
- 4.2% Natural disaster
- Other
Operating Performance by Age

Year Placed in Service

- Median Debt Coverage Ratio 2013
- Median Debt Coverage Ratio 2014
- Median Per Unit Cash Flow 2013
- Median Per Unit Cash Flow 2014
Operating Performance by Project Size

Median Debt Coverage Ratio 2013
Median Debt Coverage Ratio 2014
Median Per Unit Cash Flow 2013
Median Per Unit Cash Flow 2014
Operating Performance by Credit Type

Credit Type

- Median Debt Coverage Ratio 2013
- Median Debt Coverage Ratio 2014
- Median Per Unit Cash Flow 2013
- Median Per Unit Cash Flow 2014

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Operating Performance by Development Type

![Operating Performance Chart]

- **New Construction**
  - Median Debt Coverage Ratio 2013: 1.25
  - Median Debt Coverage Ratio 2014: 1.30
  - Median Per Unit Cash Flow 2013: $500
  - Median Per Unit Cash Flow 2014: $700
- **Acquisition Rehab**
  - Median Debt Coverage Ratio 2013: 1.35
  - Median Debt Coverage Ratio 2014: 1.45
  - Median Per Unit Cash Flow 2013: $600
  - Median Per Unit Cash Flow 2014: $800
- **Historic Rehab**
  - Median Debt Coverage Ratio 2013: 1.10
  - Median Debt Coverage Ratio 2014: 1.20
  - Median Per Unit Cash Flow 2013: $400
  - Median Per Unit Cash Flow 2014: $600
- **Other**
  - Median Debt Coverage Ratio 2013: 1.45
  - Median Debt Coverage Ratio 2014: 1.55
  - Median Per Unit Cash Flow 2013: $700
  - Median Per Unit Cash Flow 2014: $900
Operating Performance by Developer Type

![Chart showing operating performance by developer type.](chart.png)
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Key takeaways
Most LIHTC funds have delivered their projected return to the fund investors.

On average, surveyed funds had a positive 56-basis point variance between actual and projected yields.
Credit Delivery Performance

- While achieving projected yields is important, the individual components of yield computation also have significant implications.
  - More credits?
  - More losses?

- 58% of LIHTC funds have delivered the projected credits.
Credit Delivery Performance

- An average LIHTC investor has realized 98% of its promised credits.
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Key Takeaways
Key Takeaways

- Incredible strength in affordable housing demand exists in virtually every part of the country.

- LIHTC property performance is strong, with all basic metrics continuing to improve.

- The risk profile in housing tax credit investments has fallen to an historically low level.

- The industry has come a long way at improving underwriting and asset management practices.

- Due to the fact that housing tax credit properties are, by design, underwritten with a narrow margin for error, aggressive underwriting, unexpected market condition or improper management can still result in property failures.
CohnReznick Resources

Registration is Open! Affordable Housing Spring Conference – San Francisco (March 21-22, 2016)
https://www.cohnreznick.com/events/160321-2016-spring-ah-conference

Stay Posted for future 2016 Webinars!

“Housing Tax Credit Monitor” published bi-monthly in the Tax Credit Advisor

Current Study:
The Low-Income Housing Tax Credit Program at Year 30: Recent Investment Performance (published 2015)
https://www.cohnreznick.com/insights/low-income-housing-study-year-30

Special Report: The Community Reinvestment Act and Its Effect on Housing Tax Credit Pricing (published 2013)
https://www.cohnreznick.com/insights/cra-study

The Low-Income Housing Tax Credit Program: A Performance Update (published 2014)

The Low-Income Housing Tax Credit Program at Year 25: An Expanded Look at its Performance (published 2012)
https://www.cohnreznick.com/insights/low-income-housing-study

The Low-Income Housing Tax Credit Program at Year 25: A Current Look at its Performance (published 2011 under Reznick Group)

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Thank you!

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