

Housing Tax Credit Investments:
*High Performance
and Increased Need*



A CohnReznick LLP Report
Tax Credit Investment Services
2017

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Introduction

This is the sixth in a series of periodic reports issued by CohnReznick LLP that address the performance of properties financed with federal low-income housing tax credits (housing tax credits). To compile and analyze the data required for the assessment, CohnReznick requested the participation of every active housing tax credit syndicator and some of the nation's largest institutional investors. Thirty-three housing tax credit syndicators and two of the nation's largest investors participated in the survey. A complete list of study participants appears on the Acknowledgements page. This effort would not have been possible without the support of these organizations. CohnReznick analyzed data collected from more than 22,000 housing tax credit properties. For a more extensive discussion of the methodology employed to collect and analyze property data, please refer to Appendix A. We are grateful to the housing credit industry for its continuing support of CohnReznick's campaign to promote a deeper understanding of the housing tax credit program, its strengths, and the critical role it plays in the development of affordable housing.

COHNREZNICK LLP
September 2017

Report Restrictions

CohnReznick has used information gathered from the housing credit industry participants listed on the Acknowledgements page of this report to compile this study. The information provided to us has not been independently tested or verified. As a result, we have relied exclusively on the study participants for the accuracy and completeness of their data. No study can be guaranteed to be 100% accurate, and errors can occur. CohnReznick does not guarantee the completeness or the accuracy of the data submitted by study participants and thus does not accept responsibility for your reliance on this report or any of the information contained herein.

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Executive Summary



The federal low-income house tax credit (housing tax credit) is the most important program in the United States for creating and rehabilitating affordable housing. Every year, the housing tax credit program finances the construction or rehabilitation of more than 75,000 units of affordable housing that support roughly 96,000 jobs and generate \$3.5 billion in tax revenue¹. No other local, state, or federal program comes close.

Through its 30-plus year history, the affordable housing built with housing tax credits has forged an impressive record of strong financial performance. The overwhelming majority of properties financed with housing tax credits are fully occupied, with strong net cashflows and foreclosure rates that are incredibly low.

Disproving some who may view housing credit properties as a drag on a local housing market, a 2016 Trulia report² focusing on the nation's 20 least affordable housing markets determined that housing credit properties had no negative effects on nearby home values. Indeed, the estimated one-year impact of building 100 housing tax credit units included: \$7.9 million in additional local income, \$827,000 in additional tax and other revenue for local governments, and 122 additional local jobs.

¹ <http://rentalhousingaction.org/>

² Young, Cheryl; Trulia; There Doesn't Go The Neighborhood; November 16, 2016

Beyond financial performance and the positive impact to local communities, housing credit properties first and foremost are safe and healthy housing options for the nation's most at-risk populations, the working poor and elderly.

CohnReznick produces the industry track record by surveying the owners of properties financed with housing tax credit properties. The latest research shows that housing tax credit properties are operating better than in any period during the program's history.

In 2016, the surveyed portfolio, which consisted of more than 22,000 properties, reported, on a median basis, **97.8%** physical occupancy rate, **1.35** debt coverage ratio, and more than **\$600** per-unit per annum net cash flow (cash flow available after paying for expenses, mandatory debt services, and required replacement reserve contributions).

Performance continues to be strong for many reasons, primarily:

- The growing need for affordable housing supports high rates of occupancy for housing tax credit properties and strong operating performance. There are 11.2 million severely cost-burdened renter households (i.e., those who spend more than 50% of their income on housing), which is projected to increase to more than 13 million by 2025.³ Compounding the problem, there is an estimated national shortage of 7.4 million affordable rental homes for extremely low-income households.⁴

Not surprisingly, virtually all housing tax credit properties are fully occupied barring normal turnovers, many with lengthy waiting lists. From an operating performance perspective, it is not uncommon to see a favorable variance between the underwritten vacancy assumptions and actual vacancy. The better than projected performance bolsters rental revenue and provides a cushion against unexpected operating expense spikes, less than projected rent increases due to stagnant area median income growth, or other factors that could otherwise stress a property's operating performance.

- The unique public-private partnership structure of the housing tax credit program supports a very low rate of foreclosure compared to any other type of real estate. Authorized under the Internal Revenue Code Section 42, the administration of the housing tax credit program resides primarily with the state credit-allocating agencies. The real charm of the housing tax credit program, compared to most other federal affordable housing programs, lies in the reliance on sophisticated capital. In addition to underwriting reviews undertaken by the state agencies, housing tax credit developments are underwritten by privately held for-profit and non-profit lenders and syndicators who acquire, structure, and asset manage these investments for institutional investors. Ultimately, the success of housing tax credit investments is collectively "guaranteed" by stakeholders that share common goals.

³ Joint Center for Housing Studies of Harvard University; The State of the Nation's Housing 2017; http://www.jchs.harvard.edu/research/state_nations_housing; accessed July 14, 2017

⁴ National Low Income Housing Coalition; Out of Reach 2017, The High Cost of Housing; http://nlihc.org/sites/default/files/oor/OOR_2017.pdf; accessed July 14, 2017

- CohnReznick's industry experience and interviews with survey respondents allowed us to conclude that the housing tax credit industry, as a whole, has made significant strides in improving the quality of underwriting and asset management practices. For example, participants in the CohnReznick study, *The Low-Income Housing Tax Credit Program at Year 30: An Operating Expense Analysis*, indicated that the availability of benchmarked operating data from their own portfolios, state credit allocation agencies, and industry data providers have allowed them to improve their expense underwriting. The variability between underwritten and actual expenses that typified the first generation of housing credit properties has shrunk significantly, which, in turn, supports the favorable operating performance metrics reported by housing tax credit properties.

Some of these factors may change. Housing tax credit prices adjusted downward at the end of 2016. Long-term interest rates may also eventually rise to be closer to the historical level. Sources of soft financing are also becoming increasingly scarce. Two foundational factors that contribute to the success of the housing tax credit program that don't appear to be changing in the near term are the already high and increasing demand for affordable housing and the solid structure of the housing credit program.

The production power of the housing tax credit program is limited by statutory authorization, among other factors. The result is that housing tax credit production is unable to keep up with the rising demand for affordable housing.

Senator Maria Cantwell (D-WA) and Senate Finance Committee Chairman Orrin Hatch (R-UT) introduced the Affordable Housing Credit Improvement Act of 2017, a comprehensive bill to expand and strengthen the housing credit. The Affordable Housing Credit Improvement Act would increase housing credit authority by 50% over a five-year period, which would be a significant step toward addressing the rising national demand for affordable housing. The proposed legislation also contains important provisions that support housing credit development coupled with multifamily housing bonds, which currently provide critical financing to roughly 40% of all housing credit units. CohnReznick supports this bill and actively works to educate elected officials on the value of this program.

Introduction



Congress created the low-income housing tax credit program in 1986 as part of a comprehensive federal tax code reform. Adopted in the midst of dramatic tax code changes, significantly improved by the Mitchell-Danforth Tax Force in 1989, and made permanent in 1993, the program has enjoyed strong bipartisan support in the United States Congress. Strong support from Democrats and Republicans alike is largely attributable to the program's design, which is built upon public-private partnerships, affordability goals that target the working poor, and funding through tax (vs. budget) expenditures.

Moreover, the program has become the most significant resource for creating, rehabilitating, and preserving affordable housing in the United States. The National Council of State Housing Agencies estimated that nearly \$3 billion affordable apartment units have been built under the housing tax credit program since inception, which have provided homes for roughly 6.7 million low-income families, seniors, veterans, Native Americans, farmworkers, and people with disabilities that they otherwise could not afford.

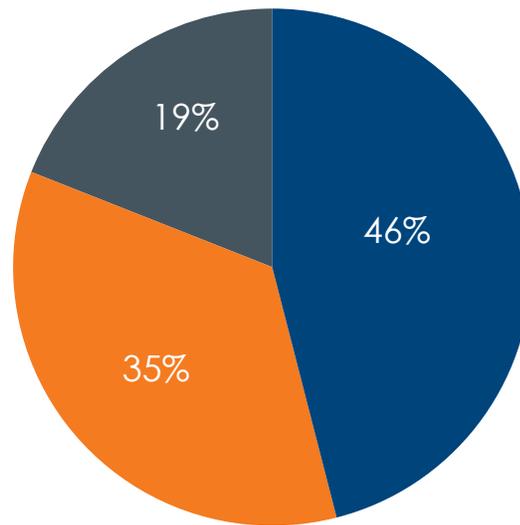
How do housing tax credits work?

Every year housing officials, typically at the state level, reserve housing tax credits for developments that will build or rehabilitate rental units affordable to households earning no more than 60% of the area median income (AMI). While 60% AMI is the upper-income limit for tax credit residency, a 2012 report published by the U.S. Department of Housing

and Urban Development Office of Policy Development and Research⁵ found that, of the households occupying housing tax credit units:

- 46% earned less than 30% of AMI, 35% earned between 30% and 50% of AMI, and the remaining 19% earned no more than 60% of AMI;

Tenant Income Profile



■ Less than 30% AMI ■ 30% to 50% AMI ■ 50% to 60% AMI

- Over 6% had at least one disabled resident;
- About one-third had at least one member over the age of 61.

Needless to say, the housing tax credit program serves the country's most vulnerable populations.

The IRS sets rules through the tax code, while administration of the program resides primarily with the state credit-allocating agencies. Ultimately, it is the state credit-allocating agencies that have the authority to determine the projects that should be awarded housing credits pursuant to a set of highly transparent procedures. As a result of the local administration, the program has proven to be highly flexible and responsive to the changing housing needs of each state.

⁵ Horn, Karen M., and O'Regan, Katherine M.; U.S. Department of Housing and Urban Development Office of Policy Development and Research; What can we learn about the LIHTC program by looking at the tenants?; July 1, 2012

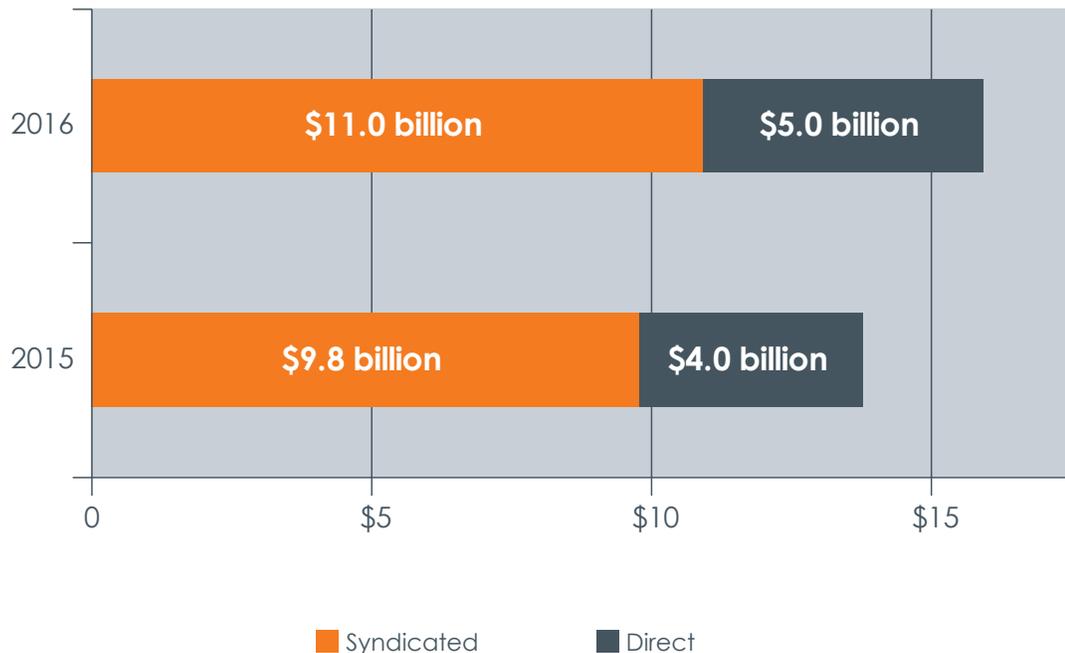
Competition for the most valuable 9% tax credits is often scored using a point system reliant on objective criteria defined by housing officials in a publicly available qualified allocation plan. In many states, the ratio of submitted applications for 9% tax credits to the credits the state has to distribute is 3 to 1. Because of the highly competitive nature of the reservation process, many developers must submit and resubmit applications, modifying their development plans to better align their project proposal with stated policy goals, ultimately improving the competitiveness of their project, before receiving a credit reservation.

Because developers of property partnerships need capital to finance their housing credit developments (and because they typically have no use for the tax benefits), the developers assign the rights to the future benefits (housing credits and losses) generated by the properties in exchange for cash. Developers monetize the housing tax credit and other tax benefits with private investors to raise the equity capital to build the affordable housing developments. Private investors also receive an ownership stake in the planned community. For roughly 10 years after construction of the affordable housing development is completed, the private investor will receive tax credits at an agreed-upon rate. To keep all of those tax credits, the affordable housing property must be maintained in accordance with the rules of the housing tax program for 15 years. If the property fails to provide safe, affordable housing, the investor could lose unclaimed tax credits and be forced to repay previously claimed tax credits.

In the housing credit equity market, investors choose between one of two primary investment approaches: direct investment or syndicated investment. Under the direct investment model, an investor directly owns a limited partner interest in a partnership that owns an underlying property, with the developer or an affiliate typically assuming the general partner role. The direct investment approach is usually feasible only for investors that have sufficient internal resources dedicated to the acquisition, underwriting, and asset management of housing tax credit investments. Consequently, this approach is favored by a handful of large institutional investors.

In a syndicated investment, a syndicator provides a limited amount of initial capital to the developer to secure the property investments, with the intention of syndicating the future stream of benefits generated by the properties to fund investors in exchange for their equity investment. The syndicator originates potential property investments, performs underwriting, and presents the potential investment to investors. In addition to acting as an intermediary between the developer and the investor, the syndicator provides ongoing asset management of the property partnerships, ensuring compliance with housing tax credit regulations and a steady stream of tax benefits to investors. In the years since the inception of the housing credit program, the lasting impact of the syndication model has been to streamline the process of pairing investment equity with property partnerships by syndicators bridging the gap between developers and investors. Based on CohnReznick's survey, we estimate that, in recent years, roughly 75% of all housing credit investments were acquired through syndication.

Total Housing Tax Credit Equity Volume

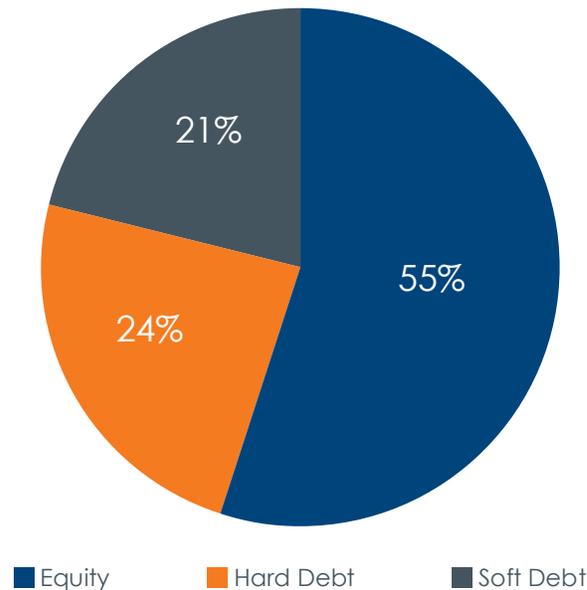


How is a typical housing tax credit project financed?

For most of the past 15 years, the demand for housing credit investments has exceeded the supply. The demand for credits has driven the price at which they trade from \$0.42 per \$1.00 of housing tax credits in the early years of the program to close to \$1.00 per \$1.00 of housing tax credits in recent years. The steady progression in housing credit prices has changed the "capital stack" in financing these developments. It is not uncommon for 9% housing credit projects to be financed 75%-80% with investor equity, with the balance coming from conventional mortgage financing and, in some cases, "soft" financing from governmental lenders.

The following graph illustrates the average capital stack of all the housing credit properties (9% and 4% included) closed since 2012.

Average Capital Stack: All Housing Tax Credit Projects Since 2012



This unique combination of capital sources allows housing credit properties to be financed with low levels of “must pay” hard debt. Ultimately, the limited use of leverage is what allows developers to rent these apartments to tenants who could otherwise not afford to live in safe, decent, affordable housing. It is for this reason that the housing credit program is referred to as a capital subsidy.

How does the public private partnership foster an efficient use of the capital subsidy?

The housing tax credit program has proven to be the most efficient capital subsidy for creating affordable housing at scale.

State allocating agencies are statutorily obligated to award only enough housing tax credits to make potential developments financially feasible, and the agencies have become very effective at ensuring that the projects to which they award housing credits are not over financed.

In addition to the underwriting that housing credit projects undergo at the state agency level, these developments are underwritten by lenders, investors, and syndicators who acquire, structure, and asset manage the investments for institutional investors. These players typically have sophisticated real estate underwriting platforms that initially supported conventional multifamily or other types of real estate assets. By leveraging their existing underwriting platforms, recruiting talented real estate professionals, and using similarly rigorous underwriting criteria (while acknowledging the uniqueness of this asset class), the affordable housing industry has made significant progress in accurately forecasting rental income and operating expenses.

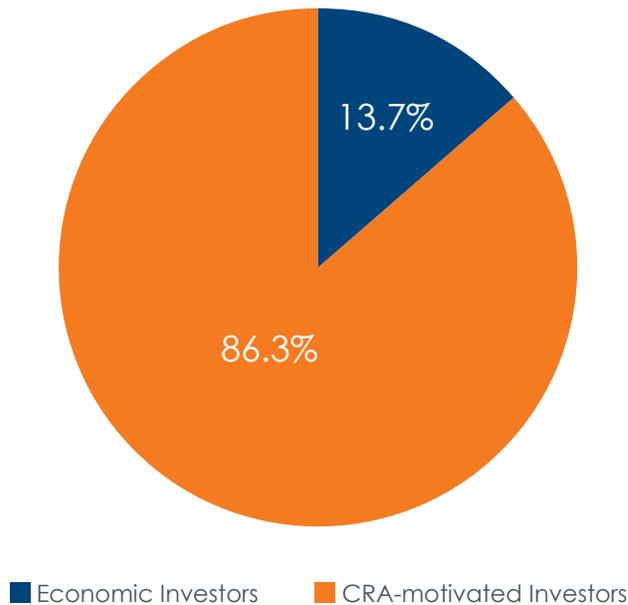
In addition to generating tax equity, housing tax credit investments attract private capital from debt providers that would otherwise be reluctant to lend to affordable housing projects. While the debt coverage, typically 1.15-1.20, affords a fairly modest buffer to break even, the lenders that operate in this space understand that the probability of severe underperformance is very low, as illustrated by the program's long-term track record.

Over time, numerous mechanisms have been built into the development and management processes to hold different participants accountable for their performance, such as payment and performance bonds for general contractors, development completion guarantees for developers, operating deficit guarantees and various tax credit guarantees, and compliance and long-term use restriction requirements for all parties.

Why do institutional investors invest in housing tax credit investments?

Since the mid-1990s, the equity market for housing tax credit investments has been predominantly composed of large, publicly traded companies, most of which are in the banking and financial services sector. As investors and regulators have become increasingly confident in the financial performance of housing tax credit properties as an asset class, the housing tax credit program has become more dependent on the banking sector as a highly reliable source of equity to meet its capital needs. This has been a largely favorable development because banks, for example, filled most of the equity gap created when Fannie Mae and Freddie Mac exited the housing credit market in 2007 and 2008. CohnReznick estimates that approximately \$16 billion of capital was committed to housing tax credit investments in 2016, and that the banking sector was the source for approximately 85% of that amount.

Housing Tax Credit Equity Market: CRA vs. Economic Volume



Multiple factors make housing tax credit investments attractive to banks:

- **Increasing after-tax earnings and lowering effective tax rate:** Housing credit investors are effectively purchasing a financial asset in the form of a stream of tax benefits (consisting of tax credits and passive losses associated with depreciation and mortgage interest deductions). Investors do not anticipate receiving cash flow distributions, because housing tax credit properties are generally underwritten to perform slightly above breakeven and developers or syndicators are generally the recipients of any remaining cash flow. Substantially all of the investors' returns are expected to be derived from tax benefits.

Banks typically report fairly stable earnings from year to year and are thus predictable federal taxpayers having sufficient taxable income against which to offset with losses and tax credits. The housing tax credit is earned over a 15-year period but is claimed over an accelerated 10-year timeframe, beginning in the year in which the property is placed in service and units are occupied. The ideal housing credit investor is a company with a track record of consistent growth in earnings that is a regular taxpayer. This has been the profile of the U.S. banking industry for most of the last 30 years, with the exception of rare recession-driven disruptions.

- **Satisfying CRA lending and investment test objectives:** Banks are obligated, under the Community Reinvestment Act (CRA) regulations, to make loans, provide services, and make investments in low- to moderate-income neighborhoods in those areas in which they take deposits. As a regulatory matter, banks are obligated to operate in a “safe and sound” manner, which requires them to avoid investments that represent potential loss of capital. The strong financial performance track record of housing tax credit investments has historically been an ideal match for bank investors with a conservative focus. There are a limited number of qualified equity investments under CRA regulations, and many of these have less attractive yield and/or risk profiles than housing credit investments. Among the available investment options, housing credit investments appear to be a clear investor favorite.
- **Achieving a reasonable/superior risk-adjusted rate of return:** The banks that CohnReznick surveyed have advised us that on a risk-adjusted basis, the yields generated by their housing credit investments are superior to most of their available community development investment alternatives. This is, in part, because banks enjoy a lower cost of funds than other investors, which widens the spread between that cost and the rate of return offered by housing credit investments.
- **Enhancing community relations and searching for cross-selling opportunities:** Notwithstanding their CRA objectives, U.S. banks have become sophisticated housing tax credit investors and have learned to leverage their equity investments to sell other products and services to the development community. Thus, we increasingly see banks cross-selling other services such as construction financing, letters of credit, permanent loans, and other products to the properties in which they invest.

How much does the housing tax credit program cost?

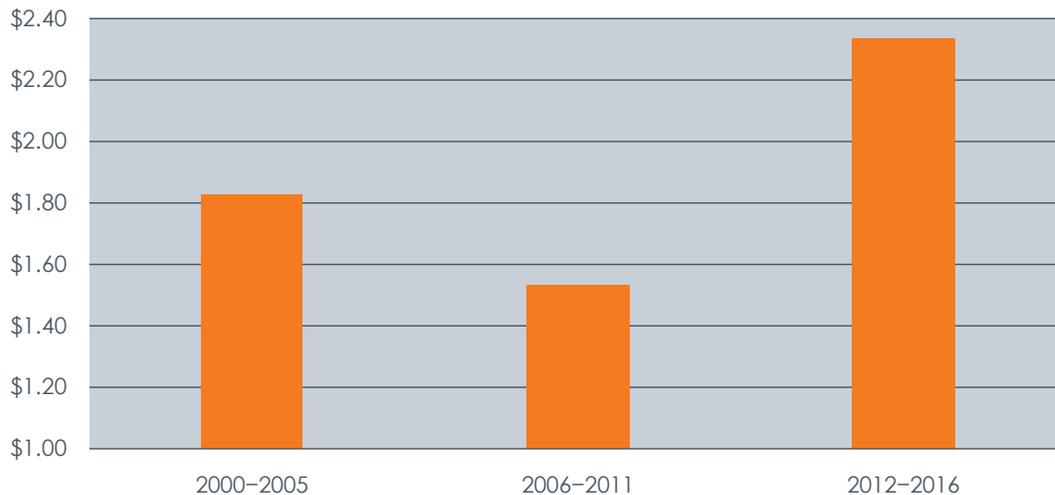
Unlike most other tax expenditures, the cost of the housing tax credit program can be calculated with precision because the program's funding authority is subject to a volume cap. The Joint Committee on Taxation estimated the costs of more than 230 tax expenditures for fiscal years 2016-2020. The housing tax credit program does not rank among the 25 most expensive tax expenditures for the federal government.⁶

⁶ Joint Committee of Taxation; Estimates of Federal Tax Expenditures for Fiscal Years 2016-2020; January 30, 2017; JCX-3-17

More important, the cost of the housing tax credit program cannot be fully understood without the following context:

- Housing tax credit investments attract private capital from equity investors and debt providers that might otherwise be reluctant to invest in, or lend to affordable housing projects. The following graph illustrates how each dollar of housing tax credit has translated into additional dollars of private funding sources since 2000.⁷ Between 2000 and 2005, the ratio of tax credits to dollars of private funding was 1.82; however if we view the most recent period, 2012-2016, this ratio increased to 2.33.

Average Dollars of Additional Private Equity and Debt Raised Per Dollar of Credit Allocated



- By design of the program, underwriting and asset management responsibilities (and therefore costs) are effectively shared by syndicators, investors, and lenders.
- The program's proven track record, including a 0.71% cumulative foreclosure rate, speaks to the extremely low "bad" debt cost of government tax expenditure.

⁷ The ratio was calculated by dividing the total dollars of hard debt and net equity in a property's capital stack by the total dollar amount of credits allocated to that property. All soft debt was considered public funds to simplify this analysis; however, this assumption understates the funding provided by credits because many soft debts like deferred developer fee, seller notes and other forms of debt are from private sources.

Cumulative Foreclosure Rate



- The cost of the program is effectively offset by the following: Per the National Association of Home Builders, the estimated one-year impact of building 100 housing tax credit units included: \$7.9 million in local income, \$827,000 in taxes and other revenue for local governments, and 122 local jobs. The estimated annual recurring impact includes: \$2.5 million in local income, \$441,000 in taxes and 30 local jobs.
- Disproving NIMBY sentiments of some who view housing credit properties as a drag on a local housing market, a 2016 Trulia report⁸ focusing on the nation's 20 least affordable housing markets showed that housing credit properties built had no negative effects on nearby home values.
- In addition to the program's crucial role in creating much needed affordable housing rental housing, the program has generated numerous savings through reduction in Medicare, Medicaid, and other spending.⁹

⁸ Young, Cheryl; Trulia; There Doesn't Go The Neighborhood; November 16, 2016

⁹ Sturtevant, Lisa and Viveiros, Janet; How Investing in Housing Can Save on Health Care; January 2016

Few Empty Apartments at Housing Tax Credit Properties

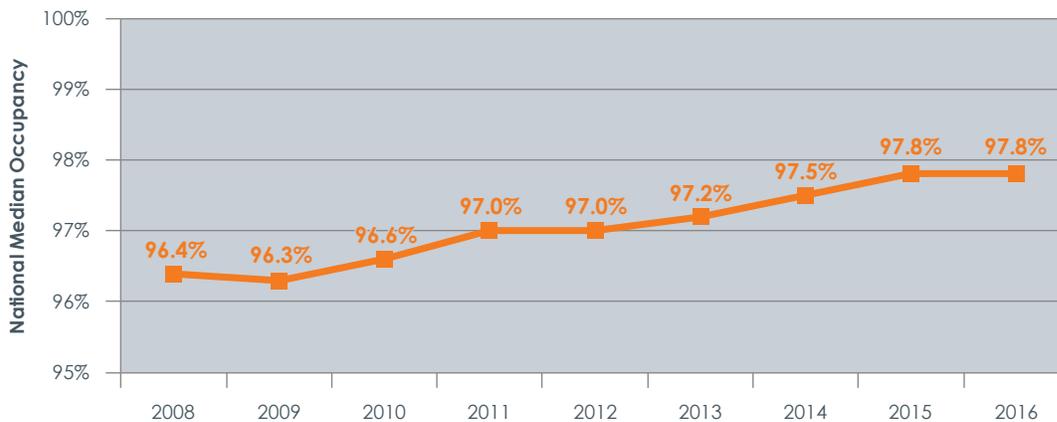
Nearly all of the housing units financed with housing tax credits are occupied, and the percentage of occupied units continues to rise.

The median physical occupancy rate across the surveyed portfolio was 97.8% in 2016, the highest occupancy rate since CohnReznick began collecting data.

In the broader apartment industry, property managers generally consider an occupancy rate of more than 95% to be fully occupied.

The national median physical occupancy rate for units financed with housing tax credits has always clustered in the 96%-97% range, confirming, year after year, the pent-up demand for affordable housing in virtually all parts of the country. Underperforming properties that reported occupancy issues tend to struggle for reasons not related to demand, but project-specific challenges such as poor design, ineffective management, or deferred maintenance. The following graph illustrates the generally increasing physical occupancy trend among the national housing tax credit portfolio from 2008 to 2016.

Median Physical Occupancy



Physical occupancy represents the number of occupied units divided by total number of revenue-producing units in a given property. The data are based on a survey of 22,000+ housing tax credit properties, including 15,000+ stabilized properties. The annual physical occupancy rate is equal to the average of the monthly occupancy rates over the stabilized period of the year.

Economic Occupancy Also Strong

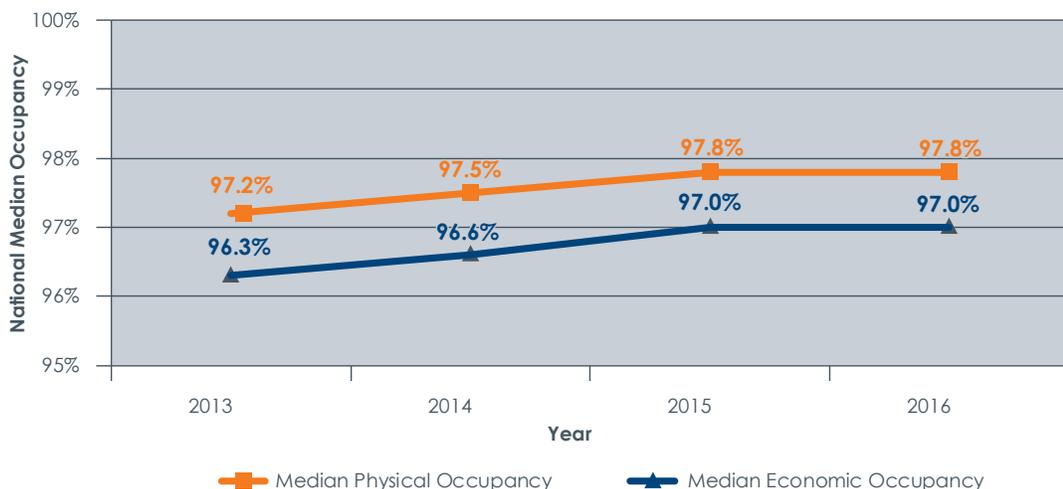
Properties financed with housing tax credits also perform well in terms of the rent collected compared to the rent potential. The income from an apartment property depends on more than simply whether its apartments are fully occupied. Property managers also must be able to collect the rent from those tenants.

Industry professionals generally underwrite housing tax credit property investments with the assumption that stabilized economic occupancy will be at least 93%, or 95% if the property is 100% subsidized or located in a strong market. The assumed economic vacancy rate takes into account the periodic turnover of units, the ability to re-lease such units, and losses from rent skips or collection problems. While physical occupancy may be calculated at 95% or higher, historical performance data confirm that it is a sound underwriting practice to assume an additional 1%–2% of economic losses beyond physical vacancy losses.

Because economic occupancy was not consistently tracked by data providers, CohnReznick was unable to gather such information before 2013. While only four years' worth of economic occupancy data is available, it is already clear that economic occupancy trails closely behind the growth in physical occupancy, indicating a fairly modest level of economic losses.

The median economic occupancy rate for housing tax credit properties was 97.0% in 2016. Since 2013, economic occupancy rates were 80-90 basis points lower than physical occupancy rates.

Overall Portfolio Median Physical and Economic Occupancy (2008-2016)



The spread demonstrates very powerfully how the demand for affordable housing units has lowered the turnover rate in housing credit properties, reduced the costs associated with units turning over, and lowered the loss in rental income associated with rent skips. In turn, this high rate of economic occupancy supports strong performance for these properties in terms of debt service ratios and cash flow.

More Low-Income Renters Need Affordable Housing

The occupancy rates for housing tax credit properties have been rising for a simple reason: the number of low-income people who need to rent a place to live has also been rising.

In early 2017, 36% of homes in the United States were occupied by renter households. That's up from a low of 31% in the fourth quarter of 2004, according to the U.S. Census. To put it another way, there were 42 million households that lived in rental housing in 2017, two million more than before the housing crash. Those millions of new renters are increasing the percentage of occupied apartments across the country, including at affordable housing properties.

Many of those new renters were once homeowners who lost homes during the housing crash. Also, many renters who might have bought homes have been unable to overcome challenges, such as the difficulty of getting a home mortgage or the heavy burden of student loan debt.

The number of extremely low-income households also rose, to 11.4 million in 2016 from 10.3 million in 2013.¹⁰ That works out to one-in-four renter households nationally in 2016, according to National Low Income Housing Coalition (NLIHC). These extremely low-income households earn no more than 30% of the median income in their local areas.

However, there were just 3.2 million rental units available in the United States that these extremely low-income households could afford, without paying more than 30% of their income on a place to live, according to NLIHC. That works out to only 28 affordable units available to every 100 extremely low-income households.

There is an absolute shortage of 8.2 million affordable units for extremely low-income households, according to NLIHC. That shortage is 9% larger than it was in 2010. The shortage has grown as the number of extremely low-income households grows more quickly than the number of units of housing affordable to them.

That's terrible news for extremely low-income households, who often pay an outsized share of their income on housing, live in overcrowded or substandard housing, or in some cases risk homelessness.

Meanwhile, the growing need for affordable housing keeps the percentage of occupied units high in properties financed with housing tax credits – with long waiting lists in many parts of the country.

¹⁰ National Low Income Housing Coalition; Out of Reach 2017, The High Cost of Housing; http://nlihc.org/sites/default/files/oor/OOR_2017.pdf; accessed July 14, 2017

Tax Credit Housing Reported Improved DCR

Properties financed with housing tax credits are also in a good position, on average, to successfully keep up with debt payments. That strong financial position was stronger in 2016 than it has ever been before.

The median debt coverage ratio (DCR) was 1.35 for surveyed housing tax credit properties in 2016. A property's DCR represents the net income produced by the property divided by the amount of its mandatory debt service payments.

For example, a project that reports \$135,000 of net income and \$100,000 of annual mandatory debt service is considered to have a 1.35 DCR. Most lenders' underwriting standards require that a housing credit property be able to generate net income that produces a DCR of at least 1.15–1.20 as a condition of retiring a property's construction loan and converting to long-term permanent financing.

A strong DCR means that the property has more income coming in than it has to spend on its expenses, including debt. The surplus can be used to replenish reserves, pay deferred developer fees or soft loans, and put the development in a stronger, safer financial position.

The median DCR of 1.35 in 2016 is the strongest DCR ever recorded for the housing tax credit properties we surveyed. The median DCR for these properties hovered around 1.15 between 2000 and 2008, increased to 1.21 in 2010 (notwithstanding the recession), further improved to 1.35 in 2016. The following graph illustrates the national portfolio trend in DCR since 2008.

Median Debt Coverage Ratio



This analysis includes only properties with loans that require regular payments. It does not include properties that carry no debt or that are financed with only "soft" debt. Soft debt refers to mortgage loans made by government agencies or other lenders that require current payments only to the extent that the project has sufficient cash flow (or in some cases, do not require any payments until the maturity of such loans even if there is surplus cash flow). Roughly 15% of the properties (by both property count and investor net equity) in our stabilized surveyed population were financed exclusively with soft debt.

Strong Cash Flow for Housing Tax Credit Properties

Properties financed with housing tax credits also produce a healthy amount of cash flow. This cash flow has improved over the years in concert with the debt coverage ratio. Overall, cash flows for housing tax credit properties were stronger than they had ever been before in 2016.

Based on preliminary data, the median cash flow was \$627 per unit in 2016, among the housing tax credit properties surveyed by CohnReznick. It's more than double the median cash flow of \$250 per unit in 2008, just eight years before. Between 2000 and 2008, housing tax credit properties reported minimal levels of cash flow, averaging between \$200 and \$250 per unit per year, after paying hard debt service and making required replacement reserve deposits.

Median Per Unit Cash Flow



Stronger cash flows are good news for housing tax credit properties; however, these properties are still tightly budgeted. By design, state finance agencies are required to allocate just enough credits to make projects financially feasible.

Because the median tax credit project comprises 77 units, the total sum of positive cash flow per property—also on a median basis—is less than \$49,000 per year.

This cash flow is not necessarily distributed to the partners that own a tax credit property. Any excess cash flow is typically run through the cash flow waterfall specified under the property's partnership agreement to pay deferred developer fees, asset management fees, and soft loans.

The improving cash flows for tax credit properties are very similar to the improving debt coverage ratios for these properties. The median cash flow is based on a larger number of properties, because, as noted earlier, properties that were financed only with soft debt were not included in our calculation of the median debt coverage ratio.

Falling Housing Tax Credit Prices May Force Properties to Borrow More

As the market reacts to uncertainty over corporate tax reform that would impact the “value” of housing tax credit investments, the price at which housing tax credits trade has generally fallen by over 10 cents between the year-end 2016 and the third quarter of 2017. If this trend continues, properties financed with housing tax credits may be forced to borrow more money from other sources to make up the difference. That could eventually weaken debt coverage ratios and cash flows for tax credit properties.

Tax credit prices rose dramatically in the years just before and just after the 2008 Recession. As housing tax credit prices rose, new housing developments financed with housing tax credits needed to borrow less money to pay for the high cost of construction. For example, hard debt, requiring regular debt service payments, made up just 17% of the permanent sources of development financing for housing tax credit property placed in service in 2013.

More recently, the median hard debt level in 9% projects increased as soft debt became less and less available.

Prices for housing credits fell sharply at the end of 2016, as tax credit investors worried that a potential comprehensive reform of the federal tax code that lowers corporate tax rates might reduce the value of and demand for tax benefits. There is a strong inverse relationship between the price paid for a property's housing credits and its level of hard debt. Debt levels may be forced higher if housing credit prices drop further.

Low interest rates have also helped to lower the debt levels for housing tax credit properties. On a net equity basis, approximately 30% of the stabilized properties we surveyed were placed in service in 2010 or later, when the interest rates available had fallen well below historic norms. A cohort of the surveyed properties was also refinanced at lower interest rates during the favorable interest rate environment in recent years. While we do not have a statistical basis for quantifying the impact from refinancing, it is clear that lower leverage and favorable interest rates have operated in concert to decrease housing tax credit properties' hard debt burden.

We also know, anecdotally, that a large number of formerly troubled properties have been able to stave off foreclosure in the past couple of years because they were refinanced on more favorable terms.

Fewer Underperforming Properties

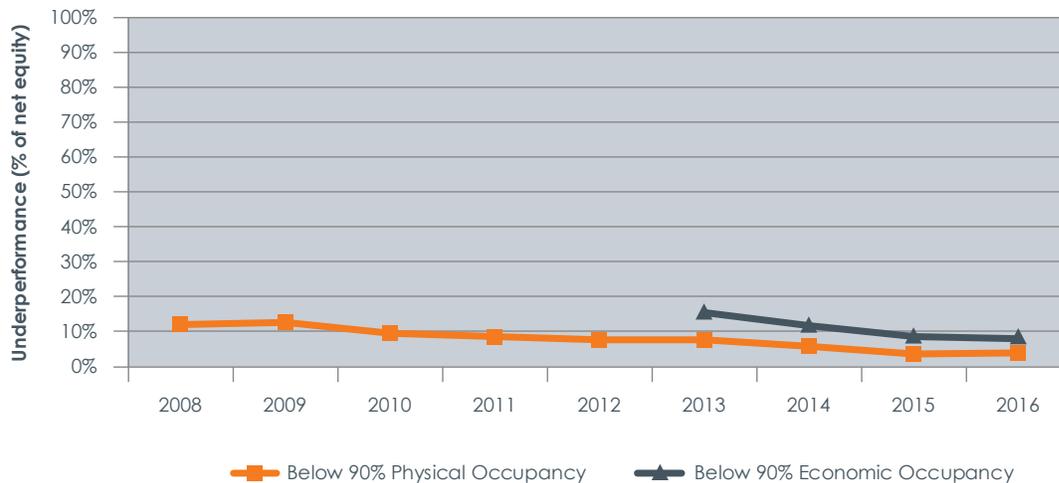
The number of housing tax credit properties that suffer from poor performance has also declined.

The average property financed with housing tax credits has shown very strong performance, and that performance has gotten stronger over the years. Of course, not all properties achieved the median level of performance for occupancy, debt coverage, and cash flow.

Of the housing tax credit properties with below-average performance, most are still in relatively strong condition. A small subset of surveyed properties are “underperforming,” meaning that fewer than 90% of their apartments are physically occupied or their ratio of income to debt service is less than 1.00.

For example, only 3.8% of housing tax credit properties (by equity) were less than 90% occupied in 2016, significantly down from 11.9% in 2008. Of these underperforming properties, most were still in relatively strong shape, with physical occupancy rates between 80% and 90%. Only 0.8% of the surveyed, stabilized properties were considered extreme underperformers, and reported that less than 80% of their units were physically occupied.

Overall Portfolio Occupancy Underperformance (2008-2016)

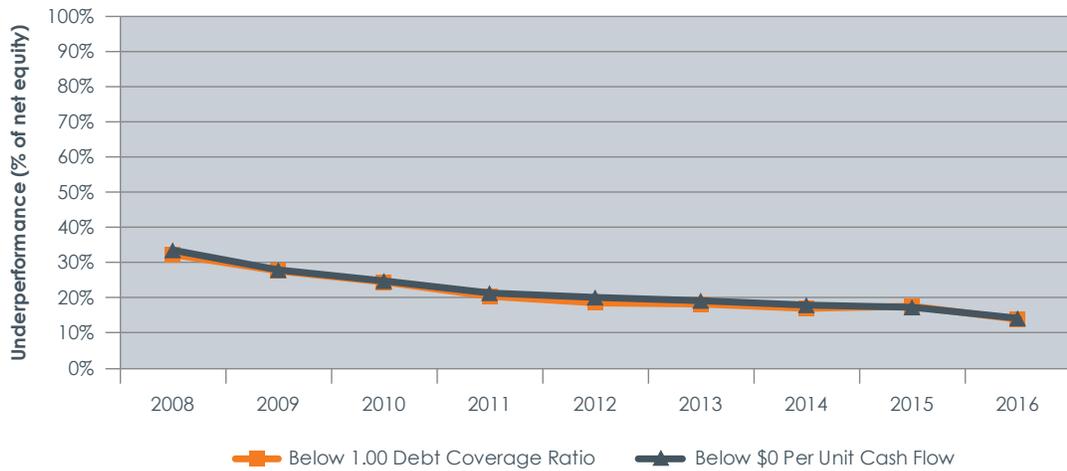


That means the effort or reinvestment needed to bring many of these properties back to a healthy level of occupancies may not be that overwhelming.

The percentage of properties where the economic occupancy was less than 90% also shrank to 7.9% in 2016, down from 15.5% in 2013. Only 1.9% of the stabilized portfolio showed economic occupancy rates below 80%.

The percentage of properties where the income was less than cost of mandatory debt payments is also shrinking. It fell to 13.8% in 2016. That's down from 35% in 2005. In addition, the great majority of properties that did not achieve breakeven operations in 2016 failed to do so by relatively modest amounts.

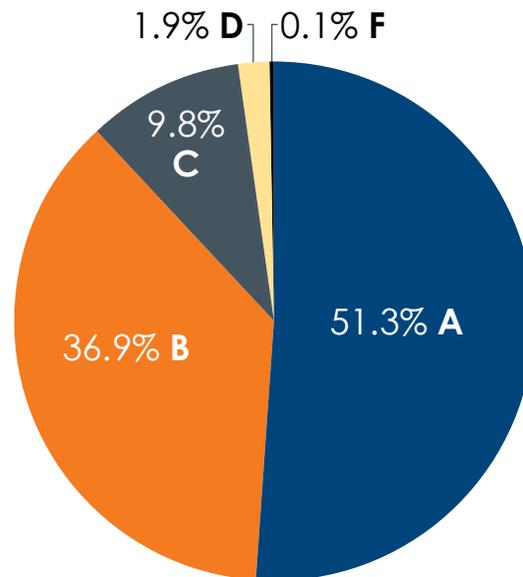
Overall Portfolio DCR and Per Unit Cash Flow Underperformance (2008-2016)



Syndicator and investor watch lists track properties through a set of defined performance measures to ensure that “problem” properties are more closely monitored. Watch list criteria can vary from syndicator to syndicator; however, most respondents have adopted the criteria established by the Affordable Housing Investors’ Council (AHIC) as a baseline for measuring underperformance.

Risk ratings are assigned to properties based on this criterion using an A through F grading scale. Properties rated “C” or worse are considered watch list properties. The following graph demonstrates the distribution of properties in the national portfolio by risk rating.

Portfolio Risk Rating Distribution: 2016



Across the national portfolio, roughly 12% of properties were on the watch list as of year-end 2016, which is down significantly from previous years.

Taking the grading analogy further, CohnReznick tied traditional grade point average scoring to the risk rating concept to arrive at a Property Performance Average (PPA). Properties rated "A" are worth 4.0, "B" properties are worth 3.0, and so on. Using this methodology, the national housing credit portfolio reported, on an equity weighted average basis, a 3.4 PPA. Using the CohnReznick PPA grading system, the housing credit portfolio has achieved a "B+" average nationwide.

Even After the Great Recession, LIHTC Foreclosures Just 0.71%

A remarkably low number of housing tax credit properties fall victim to foreclosure in any given year and through the program's history.

That is largely because relatively few housing tax credit properties suffer from severe underperformance. In many cases, underperforming properties are able to fund their operating deficits through fee deferrals, operating deficit guarantee and reserves, or advances from the general partner or syndicators. The owners of housing tax credit properties have a variety of options to financially support or recapitalize their properties.

Also, the consequences for these owners are very harsh; owners are highly motivated to keep their properties in compliance with rules of the housing tax credit program and avoid foreclosure at all costs. If an owner forfeits title to a housing tax credit property because of foreclosure or by tendering a deed in lieu of foreclosure while the property is still within its 15-year initial compliance period, the transfer would, in most cases, trigger the "recapture" of the project's tax credits.

During such a recapture event, the owner loses any projected future housing tax credits from the foreclosed property. The owner is also forced to repay one-third of the tax credit previously claimed from the foreclosed property. Additional interest and penalties may apply, which may or may not be covered by a recapture guarantee backstopped by the guarantors of the transaction.

The respondents to CohnReznick's survey report that they have lost only 156 to foreclosure, including circumstances in which a deed may have been tendered in lieu of foreclosure. Compared to the total number of properties currently owned by the respondents, this works out to a cumulative foreclosure rate of 0.71%.

Properties lost to foreclosure reported large and sustained cash flow deficits. These properties typically suffered low occupancy levels, poor sponsorship, or defective construction, among other issues.

The Great Recession also put pressure on housing tax credit properties. Of the 156 reported incidences of foreclosures, 114 were foreclosed during the period 2008–2014, including 44 that were foreclosed between 2012 and 2014. This is also the result of housing credit syndicators' effort to minimize the financial impact to investors. This is evidenced by the fact that, on average, a foreclosed property was in its 11th year of credit delivery period when lost to foreclosure.

The number of foreclosures may be understated because CohnReznick was unable to obtain data from syndication firms that have left the business or have become inactive. CohnReznick has reason to believe, strictly on an anecdotal basis, that the incidence of property foreclosure has been higher among these firms than the rest of the industry. Nevertheless, CohnReznick believes that inclusion of defunct syndicators' data would not significantly affect our conclusion on the overall safety of housing tax credit investments. Moreover, the firms we surveyed represent the core of the housing tax credit industry, and the care with which they finance and manage their investments is an important part of why the foreclosure rate of housing tax credit properties continues to be so low.

In addition to missing data from defunct syndicators, the cumulative foreclosure rate was calculated based on the total number of properties currently in survey respondents' collective portfolio, rather than the total number of properties the respondents have syndicated or invested in to date. As such, including a larger base of properties could at least partly offset the impact of missing data from defunct syndicators.

Foreclosure Rates for Housing Tax Credit Properties Far Below Conventional Apartments

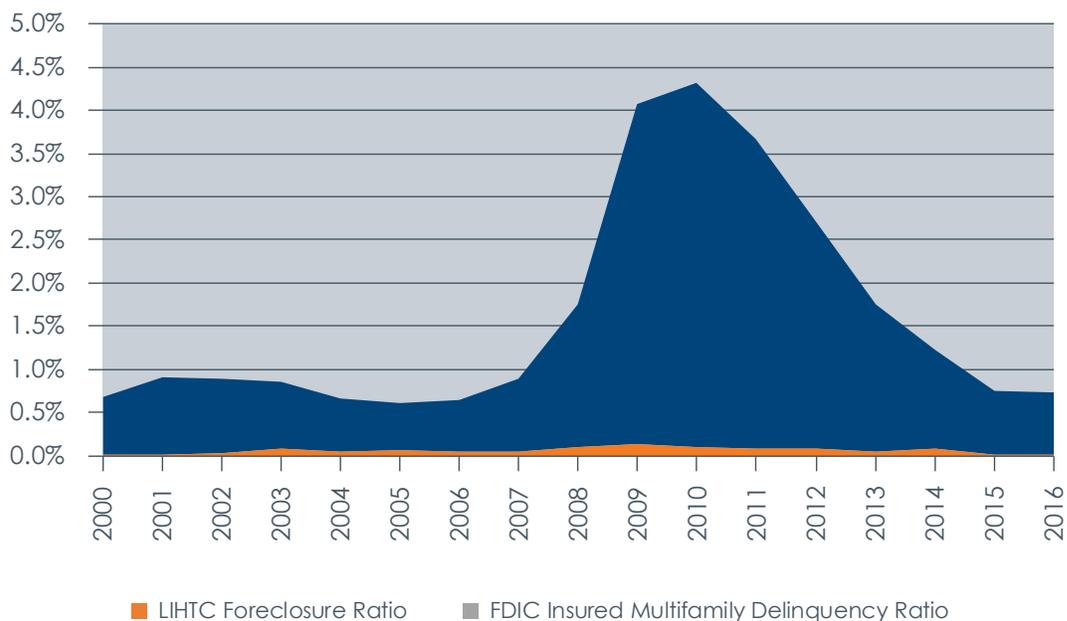
Housing tax credits properties have a cumulative foreclosure rate of just 0.71%, according to the respondents to CohnReznick's survey.

The less than 1% foreclosure rate has proved to be a very meaningful data point for regulators who rate the risk of housing tax credit investments. The very low risk rating affects the amount of capital that regulated financial institutions like banks have to hold in reserve to offset the risk of their investments. The low foreclosure rate of housing tax credit properties is also important as investors seek credit approvals to make equity investments in housing tax credit transactions.

The annual rate of foreclosure for LIHTC properties is even lower than the cumulative rate – less than 0.1%.

Conventional apartment properties are much more likely to suffer foreclosure. The chart below shows the annual housing tax credit foreclosure rates compared to the rate at which conventional multifamily loans were seriously delinquent by more than 90 days or in foreclosure, as reported by FDIC-insured institutions according to the Mortgage Bankers Association of America.

Annual LIHTC Foreclosure Rate vs. Conventional Multifamily Delinquency Rate



APPENDIX A

Survey Methodology & Data Appendix

This report represents the sixth in a series of studies undertaken by CohnReznick concerning the Low-Income Housing Tax Credit Program. In March 2016, CohnReznick transmitted data requests to all active housing credit syndicators known to the firm and a number of the nation's largest housing credit investors. Investor respondents were asked to provide data limited to direct investments and fund-level performance to mitigate what would otherwise be a large overlap of properties' data assembled from participating syndicators' portfolios.

CohnReznick believes that the more than 22,000 properties, the sample size represented in this study, are in excess of 70% of the housing credit properties placed in service since the inception of the program that are being actively asset-managed by syndicators and/or investors. By "actively" managed, we refer to those properties that are within their compliance periods (or just beyond), for which an asset manager would produce quarterly or annual reports. We suspect the gap between CohnReznick's data set and 100% of all properties is largely a result of defunct syndicators, as well as properties placed in service in the earlier years of the housing credit program that have reached the end of their compliance periods, have been disposed of, and have "cycled out" of the program. Additionally, direct investments account for a smaller portion of our data set than we would have expected because of incomplete information and/or lack of participation of the largest direct investors. Direct investments are investments made by a single corporate investor directly into a project partnership as opposed to investing through a fund managed by a third-party syndicator. In future reports we plan to capture data for a larger portion of this segment of the market. We believe that the sample size represented in the study provides a statistically meaningful basis for our analysis and findings.

Data Collection

A participant solicitation email and data collection template were sent to the aforementioned organizations in March 2016. Respondents were initially requested to return the data collection template no later than June 2016. However, a few participating respondents indicated that they lacked sufficient time to complete the survey properly, and they were offered a deadline extension. All contacts, whether made by telephone or email, were recorded in response contact logs.

Data Collection Template

The following shows the main data points requested from each participating investor and syndicator. Instructions were attached to each collection field to minimize interpretation. Contact information for CohnReznick professionals was supplied along with the collection template for questions related to the data request.

Where applicable, audited financial data were requested and were represented as having been furnished in that form. However, CohnReznick did not perform any independent validation as to whether the data were indeed audited.

DATA FIELDS	DEFINITION/EXPLANATION
PROPERTY INVESTMENT IDENTIFICATION	
STATIC DATA	
Fund name	Provide the name of the fund each property belongs to. In cases where property interest is split among multiple funds, please assign the property to the fund that owns the majority LP interest. Ensure that fund names are consistent between the fund and property tabs.
Fund type	Select from: Direct, Proprietary, Multi-investor, Guaranteed, Public. Ensure the fund types are consistent between the fund and property tabs.
Property name	Provide the name of the property or a unique identification number from your database that will permit future identification.
Property address	Enter the street address, city, 2-letter state abbreviation, and 5-digit zip code.
Type of credit	Select either 4% or 9%.
Total development cost	Enter the total development costs; aka the total sources of funds.
Total net equity (federal LIHTC only)	Enter total net equity contributed for federal LIHTC credits only. Do not combine state or any other credits. Use closing projected amount and enter the full dollar amount (e.g., \$2,000,000 instead of \$2 million).
Total projected federal LIHTC to LP	Enter total federal LIHTCs projected to be delivered to LP at closing. Do not combine state or any other credits.
Development type	Select from: New Construction, Acq/Rehab, Historic Rehab, and Other.
Tenancy type	Select from: Family, Senior, Special Needs, Supportive Housing, and Other. Enter "Special Needs" for properties predominantly serving special needs population (homeless, survivor of domestic violence, people with disabilities, etc.). "Supportive Housing" are properties with a significant service component attached.
Developer type	Select from for-profit and non-profit.
Affiliated management company (Yes/No)	Select "Yes" if the management company is affiliated with the property's developer. Select "No" if it is not affiliated.
Total number of units	Enter the total number of units.
Total number of LIHTC units	Enter the total number of LIHTC units, including manager's unit that is treated as tax credit unit for the applicable fraction purposes.
Project-based rental assistance	Enter "Yes" for properties benefiting from project-based rental assistance, either partial or full. Enter "No" if there are no project-based rental subsidies.
Type of rental assistance	Select from: Project-based Section 8, RD, ACC, and Other. Choose the major assistance type if more than one is received.
Hard debt	Enter "Yes" if the property is financed with hard debt. Enter "No" if the property has no hard debt.
Hard debt ratio	Enter % (hard debt / total project costs). Enter 0.0% if project has no hard debt.

DATA FIELDS	DEFINITION/EXPLANATION
PROPERTY INVESTMENT IDENTIFICATION	
VARIABLE DATA	
Property status	Select the property's status as of data submission. Select from: Pre-Construction, Construction, Lease-up, Pre-stabilization (leased-up but not yet stabilized), Stabilization (converted to perm loan and met the "stabilization" milestones specified in the LPA), Disposition, Foreclosure, Deed-in-lieu, and Other.
Closing date	Enter the actual lower-tier closing date. (MM/DD/YYYY)
Placed in service date	Enter the actual or projected PIS date. If there are multiple buildings on a property with multiple PIS dates, enter the date when the first building was placed in service. (MM/DD/YYYY).
Stabilization date	Enter the property stabilization date. (MM/DD/YYYY).
Physical occupancy	Enter the physical occupancy rate for the year specified. Annual physical occupancy is the average of monthly physical occupancy. For projects that did not have a full year of stabilized operation, enter the occupancy rate during the stabilized period only.
Economic occupancy	Enter the economic occupancy rate for the year specified, based on audited financials. Economic occupancy is defined as actual collected rental income divided by gross potential rental income. Economic occupancy is affected by vacancy loss, loss to lease, rental concessions, and bad debt.
DCR (all hard debt) or Income Expense Ratio (no hard debt)	Enter the debt coverage ratio or the income expense ratio for the year specified, based on audited financials. Debt coverage ratio is defined as: (net operating income - required replacement reserve contributions) / mandatory debt service payments. If the property has no hard debt, enter the income expense ratio, which is defined as operating income/operating expenses (including replacement reserves).
Net cash flow per unit per annum	Enter the per-unit cash flow for the year specified, based on audited financials. Per-unit cash flow is defined: as (net operating income - required replacement reserve contributions - mandatory debt service payments)/total number of units. For projects that did not have a full year of stabilized operation, enter the annualized per-unit cash flow during the stabilized period only.
Operating deficit funding source	If the property incurred operating deficits during the effective year (2016 only), choose from the following funding sources: investor capital call, upper-tier reserve, syndicator advance, lower-tier reserve, GP advance, debt restructuring or management fee deferral.
AHIC watch list (Yes/No)	Select the property's risk rating status as of the property data effective date (12/31/2016). Please be sure to indicate the date used for AHIC ratings in field B9 above. Enter "Yes" if the property is on your organization's watch list based on AHIC standards.
AHIC rating	Select the property's status as of the property data effective date (12/31/2016). Please be sure to indicate the date used for AHIC ratings in field B9 above. Enter the property's corresponding AHIC rating: A, B, C, D, F.

DATA FIELDS	DEFINITION/EXPLANATION
FORECLOSURE DATA	
Year of foreclosure	Enter the year when the property was foreclosed.
Calculated year of compliance period	Automatically calculated based on the First Year of Credit Delivery and the Year of Foreclosure.
Reason for foreclosure	Enter the reason for foreclosure.
Total recaptured and lost federal LIHTC	Enter the sum of the recaptured federal LIHTC amount and the future federal LIHTC amount that was foregone due to the foreclosure.
Was the LP covered by recapture guarantee? (Yes/No)	Enter "Yes" if the investors were covered by recapture guarantee; otherwise, enter "No".
Describe negative financial impacts to the investors	Describe negative financial impacts to the investors in terms of IRR, penalty, etc.
Describe negative financial impacts to you as syndicator	Describe negative financial impacts to your organization as syndicator. Describe how much you had to contribute from your own pocket in your effort to save the property. Describe your funding source.

Data Processing

The receipt of a completed survey questionnaire and any relevant comments made by the respondents were recorded in the contact logs. All questionnaires were first analyzed for data completeness and systematic errors for reasons such as misinterpretation. If questionnaires were returned with incomplete data, respondents were contacted immediately to determine the possibility of providing missing data and, in limited circumstances, the consequences of participants being unable to accommodate the entire data request. Other follow-up activities were conducted to ensure data integrity. Upon completion of the first round processing, data were compiled, filtered, and normalized.

Each data element provided was then uploaded to an Access database maintained by CohnReznick. The database was built in a completely confidential manner to ensure that no individual data points or groups of individual data points could be attributed to any data provider. The data were loaded into the database to ensure the consistency of field data types and to allow for flexible and repeatable calculation.

Data entered into the database were checked for arithmetical errors and flagged for any large discrepancies between the current and previous years' data for trend warnings. Based on industry standards and a lengthy programmatic filtering system designed by CohnReznick, outliers that could skew the study results were screened and later removed from the affected calculations. Based on predefined data outputs and calculation definitions, CohnReznick ran queries and wrote scripts to perform calculations and group datasets (e.g., linking Zip Codes to applicable counties) for segmentation analysis. Aggregated data and outputs were re-exported into an Excel template for further testing and quality control analysis.

About Us

About the Tax Credit Investment Services Group

The Tax Credit Investment Services (TCIS) group is a dedicated business unit within CohnReznick focused on evaluating and advising clients on tax-advantaged investments, including low-income housing, historic rehabilitation, new markets, and renewable energy. As a group made up of experts with a fairly narrow industry focus, TCIS covers a variety of consulting areas, including investment due diligence, investment and business strategy, and industry benchmarking research for the benefit of investor and syndicator communities.

The TCIS team is composed of a multidisciplinary group of professionals, including CPAs, attorneys, financial analysts, and other professionals with experience as state housing finance agency and commercial real estate executives. CohnReznick's TCIS team members have authored a number of affordable housing industry studies, speak regularly at industry conferences, and have been widely quoted in the financial press concerning tax credit investments.

In addition to the professional experience of TCIS team members, the group's clients benefit from the knowledge and experience of hundreds of CohnReznick audit, tax, and consulting professionals working on investment tax credit transactions on a daily basis.

For more information about TCIS, please visit www.cohnreznick.com/tcis.

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About CohnReznick

CohnReznick LLP is one of the top accounting, tax, and advisory firms in the United States, combining the resources and technical expertise of a national firm with the hands-on, entrepreneurial approach that today's dynamic business environment demands. Headquartered in New York, NY, and with offices nationwide, CohnReznick serves a large number of diverse industries, including Affordable Housing, CohnReznick's largest industry practice. The Firm also offers specialized services for middle market and Fortune 1000 companies, private equity and financial services firms, government contractors, government agencies, and not-for-profit organizations. The Firm, with origins dating back to 1919, has more than 2,700 employees including nearly 300 partners and is a member of Nexia International, a global network of independent accountancy, tax, and business advisors. For more information, visit www.cohnreznick.com.



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