Local Resources Play Oversized Role in 4 Percent LIHTC Deals

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Location is nearly everything when determining the growth of 4 percent low-income housing tax credits (LIHTCs).

“It depends on where you are looking,” said Mark Shelburne, senior manager at Novogradac Consulting LLP. “What’s interesting is to look at particular states where they make policy to help [with 4 percent LIHTC-bond transactions]. Colorado is a headliner. The state brought back the state credit and upon doing so, they set production records year after year. They are using the state credit for bond deals. Another state is Georgia–because of their policy changes, they’ve been putting in state resources.”

There’s more.

“I think it varies not only from state to state, but year to year and QAP [qualified allocation plan] to QAP,” said Jack Aronson, director of development acquisitions at Community Preservation Partners in San Francisco. “What you see across the West is more focus on bond housing. You’re seeing [local] measures passing.”

In many locations, the presence of a state LIHTC is a game-changer.

“State credits are a critical gap-filler,” said Anthea Martin, senior vice president with Bellwether Enterprise in Denver. “Colorado is like the rest of the nation: there’s a housing crisis, but [it does have] a state LIHTC.”

The affordable housing crunch has created momentum for local initiatives ranging from a $258 million housing bond in Portland, Ore., to a $74 million bond in Asheville, N.C., to a $50 million bond in Rhode Island to a series of local sales tax increases or bonds in Northern California. Those help fill funding gaps for 4 percent LIHTC developments.

However, Kenji Tamaoki, principal at PGIM Real Estate Finance, the commercial mortgage business of PGIM, the global investment management business of Prudential Financial Inc. in San Francisco, said things change quickly.

“There’s money now that didn’t exist five years ago,” said Tamaoki. “Especially housing bonds at the local level. That’s due to a greater awareness of the need for affordable housing by the general public. Unfortunately, there are so many competing demands–transportation, infrastructure and other things–that it’s hard to go back to the well too many times and ask for more.”

Less than a year after federal tax reform legislation posed a threat to tax-exempt bonds, which pair with 4 percent LIHTCs, the market is adjusting.

Big Part of LIHTC World

When the House of Representatives passed its version of the bill that ultimately dropped the corporate tax rate from 35 percent to 21 percent in November 2017, the legislation contained a provision to eliminate tax-exempt bonds. A Novogradac study showed that eliminating 4 percent LIHTC transactions would result in a loss of about 800,000 affordable housing units over a decade, information that helped re-introduce bonds into the final version of the tax-cut legislation.

“I think many people have been surprised at the extent of bond deals are of unit production, because it’s not distributed equally across the country,” Shelburne said. “Some states would have hardly seen a reduction, but [the loss of bonds] would have been very consequential in a number of states.”

The threat made an impact.

“I think it was a huge time for our industry,” said Aronson, who added that he considered the potential loss of bonds as an “oversight” by Congress, not the intent of the House legislation. “Given that the bill explicitly protected and retained the 4 percent credit, but repealed the tax-exempt status of private activity bonds, which is an essential requirement for the use of the 4 percent credit.”

Need for Other Funds

Since the 9 percent and 4 percent LIHTC target different populations, there is a different availability of soft money to fill the gaps.

“Factors for the 9 percent LIHTC are very different than a 4 percent deal,” Tamaoki said. “Most agencies are using additional subsidies to target the very lowest income people–homeless veterans, homeless families, those who need services. Bonds traditionally focus on lower-income, but not the lowest of the low, so the question is if you can find more funding.”

Which is where additional local and state sources come into play.

Gayle Ellis, senior vice president at PNC real estate, said many states make additional soft money–and state tax credits–available to help 4 percent LIHTCs. Ellis said this particularly helps with new construction, citing Wisconsin’s new state LIHTC that is used only to help with 4 percent deals.

“States are able to spread the wealth, even with limited resources,” Ellis said.

State and local help is crucial in a period of shrinking federal help.

“All those deals have a gap,” Martin said. “There have been cuts to HOME and [Community Development Block Grant] CDBG grants, which used to be such gap fillers. It’s more and more important that we have gap fillers.”

Creativity at Work

An example of a major local initiative is the $258 million affordable housing bond in Portland, Ore. That legislation ran into constitutional problems because state law forbids mixing public and private funds, which rules out the best use of the bond: as gap funding in 4 percent deals, which requires layering. The work housing advocates are doing to tweak the initiative to allow commingling shows the creativity that makes 4 percent deals work well.

“One of the things I like about affordable housing is how creative it is,” Tamaoki said. “We may be seeing redevelopment agencies 2.0 [in California, where legislation eliminated them in 2011] and people will think about how to do it differently than the first time.”

There’s no argument that the 4 percent LIHTC program is essential.

“The industry has an aging portfolio,” Ellis said. “States are beginning to realize some of these properties can be converted to market-rate housing. They’ve reached the end of the compliance period and regulatory requirements. States need to be concerned about the product and maintaining the portfolio. The goal is to add affordable units.”

However, the combination of lower tax rates for corporations and higher construction costs made it tough.

“In Colorado, the number of applications has been cut in half,” Martin said. “We’ve seen a decline in applications for new construction. The overall market is down, because of rising interest rates, higher construction cost and other things made deals not pencil out. It’s harder to make deals work.”

Legislation Would Help

Advocates say the Affordable Housing Credit Improvement Act of 2017 includes two provisions that would specifically help 4 percent deals–the minimum 4 percent rate and the ability of state agencies to give a basis boost. The new opportunity zones incentive and income averaging–which went into effect this year–also play a role in boosting bond-financed housing, although adjustments are continuing.

“In the future, it’s going to be interesting how income averaging and opportunity zones truly boost those deals,” Martin said. “There’s a lot of conversation about it.”

Outlook Upbeat

Despite all the turmoil, affordable housing insiders are cautiously optimistic about the 4 percent market.

“I think the best word is ‘hopeful,’” said Martin. “The reason is because certain things have occurred the past few years–[such as] scares in the market with cuts that would have affected the credit. Instead, we got boosts like income averaging, opportunity zones and Fannie [Mae] and Freddie [Mac] coming back in the LIHTC equity market. All these components are positive indicators.”

Aronson said the depth of the investor pool and the age of properties make the 4 percent credits more important.

“I think a couple of factors are at work,” Aronson said. “It’s clear that the LIHTC program is the most successful affordable housing program that the U.S. has embarked on and it has bipartisan support. … But as you start to see 9 percent deals come of age, a lot are going to need to be redeveloped, whether it’s a 9 percent or 4 percent credit. Some iteration of the program is likely to survive and thrive.”

Overall Demand Remains High

Public awareness of the need for more affordable housing is crucial to the bond program.

“Not that long ago, 60 percent AMI [area median income] rents were pretty close to market values,” Tamaoki said. “If you earned 70 percent of the AMI, you could afford a market-rate apartment. Now, in many places, market rent is at 100 percent or 120 percent [of AMI]. There are a lot more people who have a personal understanding of the need for affordable housing.”

The 4 percent LIHTC developments help meet the need.

“I think that the future is bright, we just don’t know what it is,” Tamaoki said. “I like the fact that the bond program is production-oriented and lets the market find creative ways to meet needs.”

Ellis sees it simply: the 4 percent LIHTCs are a key way to build housing.

“I think states are feeling obligated to provide more affordable housing as the cost of housing increases,” Ellis said. “Some have significant goals and they can’t be met with just the 9 percent credits.”

Link: https://www.novoco.com/periodicals/articles/local-resources-play-oversized-role-4-percent-lihtc-deals