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Developers Try New Strategies to Make Affordable Housing Pencil in the Pandemic

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By **Les Shaver** | May 20, 2020 at 06:55 AM

While most of the attention in affordable housing remains focused on rent collection and resident stability, Anand Kannan, president of Community Preservation Partners, says COVID-19 has significantly affected how affordable housing deals are financed.

"Typically, affordable housing deals are financed through debt and equity through the sale of tax credits," Kannan says. "Both have seen big changes as it relates to demand, underwriting and social responsibility."

Tax credit equity is posing one of the biggest challenges in the market. "As more banks are experiencing record losses and dealing with PPP loans and other priorities, it has reduced the urgency and increased demand for any sort of tax credits," Kannan says. "Banks were the largest investor in Low Income Housing Tax Credits, and they essentially drive the market as their needs or return parameters change.

With bigger banks putting a pause on tax credit investing, Kannan says it strains development finances and makes it a real challenge for everything to pencil out.

Much like lenders, developers also have to consider different options.

"As developers make choices on how to balance deals, they must weigh what the impact of financial changes are on the residents' lives versus what hits the bottom line of the company income statement," Kannan says. "There are tradeoffs that developers might have to make to ensure that deals pencil without sacrificing the quality of renovations and services for residents."

Investors invest in affordable housing to achieve high rates of return. With the demand for tax credits and the number of investors in the market decreasing, requirements for a higher internal rate of return will increase, according to Kannan. "Hoping for pre-COVID pricing from an equity investor is a pipe dream," he says. "We are pricing new deals at about 100 bps [basis points] higher than what we had pre-COVID."

To adapt to the new reality, Kannan says groups need to realize that not every deal will be a home run. "It is our belief that if a deal can be done quickly, it is worth it to take a hit on the bottom line to ensure that you are able to actually close," he says.

To complete deals, it may be necessary to price in higher reserves and renovation costs and potentially lower rent collections during construction. "Pushing the envelope in all areas will mean that a deal will not have the capability to sustain any further changes to the market," Kannan says.

Still, it is important not to stretch deals too thin. "The problem with certain developers is that they have too much hope," Kannan says. "Hoping for low-interest rates, high tax credit demand, reduced renovation costs, and higher rents to make a deal pencil is not a good strategy in this environment. Being aggressive and hopeful is one thing, but not being realistic can really cause significant damage to making a deal work."

Ultimately, being too aggressive can be harmful to more than just a company's bottom line.

"At the end of the day, the goal is to create a safe, healthy, affordable place for residents to call home, and stretching every element too thin can only harm the benefit that you are striving to bring to the resident," Kannan says.