HOUSING CREDIT CONNECT 2018

CHICAGO • JUNE 19-22

Achieving Long-Term Affordability
What's Happening Out There?

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TCAM

Agenda

- One Program but Hundreds of Stories
- What We're Seeing
- What is the Risk to Long-Term Affordability?
- The Bad News
- The Good News
- What is to be Done?

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- Lots of variation in properties – and in markets

Beware of Generalizations

- There is tremendous variation across and within markets about all aspects of Year 15 tax credit properties
- Occupancy is high almost across the board and operating performance is generally strong
  - But many properties operate with little margin for error
- Rents and expenses at Y15 vary considerably by market, by age and size of property
  - When and how the deal was originally underwritten also a factor
- Regulatory regime varies – both programs and how they are implemented and enforced
  - LIHTC
  - Mortgage financing
  - Subordinate loans from cities, counties, states

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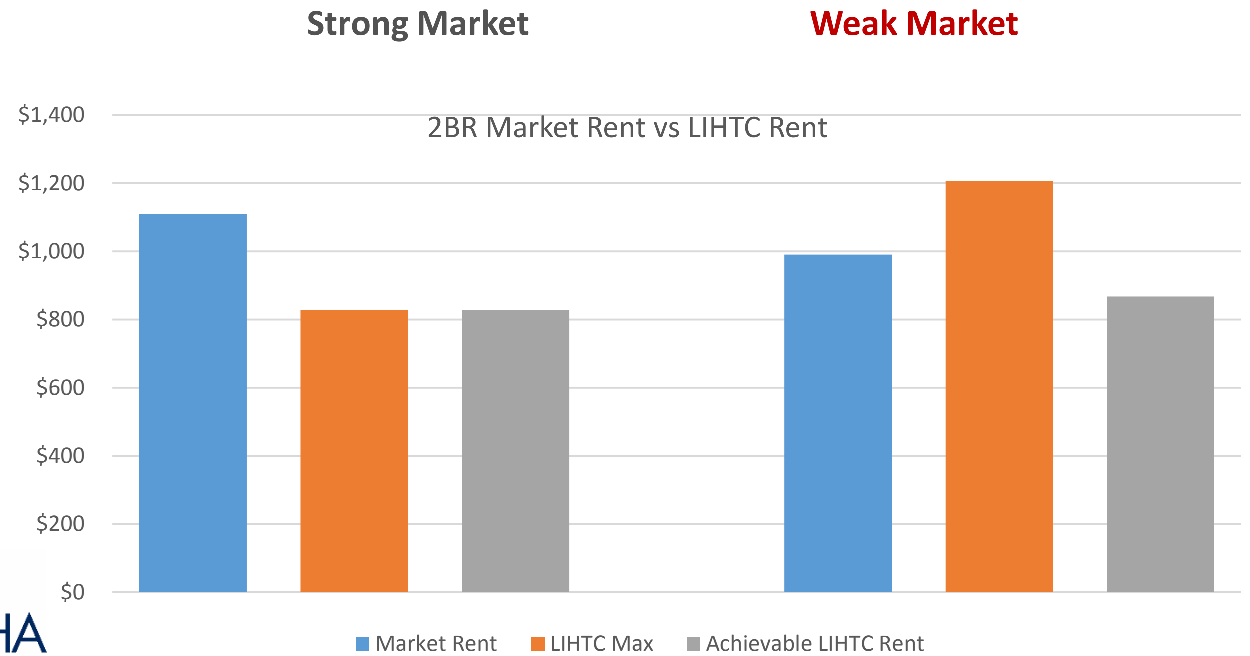
Strong Markets, Weak Markets and Everything in Between

- The difference between tax credit and markets rents varies enormously
- Difference has implications for long-term preservation



Operating Margins Also Vary Considerably

- Operating margins also vary considerably
  - Property type, size and market are factors, as is strength of original underwriting and changes over 15 years
- Properties with lower operating margins struggle to cover expenses and often defer maintenance and capital repairs

Physical Condition

- Property condition varies widely – by age, climate, tenancy, operating margin
- Implications for long-term preservation:
    - Affects both *uses* and *sources*

What's the Risk to Long-Term Affordability?

- Owners that want to increase real estate value by raising rents to market
  - That can't happen right away but there are buyers whose long-term plan is to wait out the restrictions

    →Affordability at risk

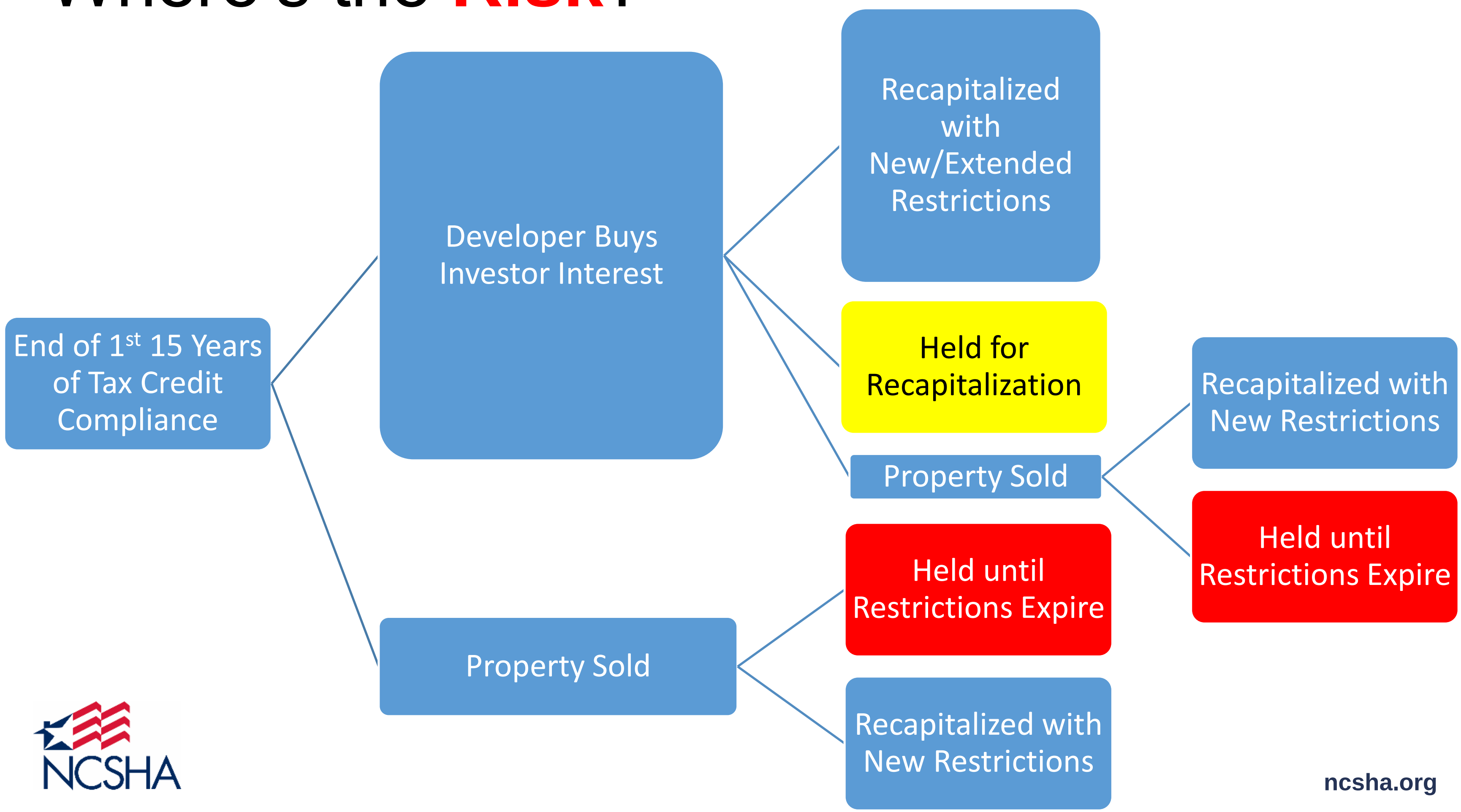
- Properties that are operating on the edge and need fresh capital to remain in decent condition

    →Viability at risk

What We're Seeing

- Lots of Year 15 deals – and many owners and investors are working on exits in Year 10+
- Most deals have long-term affordability restrictions
  - We see very few Qualified Contract transactions
- In most cases, the General Partner is looking to retain control of the property, not sell it into the open market
  - Wants to buy the interest of the LP and keep the property
  - In most cases, the intent is to maintain affordability
- Once the LP exits, many years can pass before anything changes
- But: there are plenty of prospective buyers interested in finding deals that can go to market

Where's the Risk?



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The Bad News

- In strong markets, the financial pressures and incentives to find a way out of affordability restrictions will be immense
- There are nowhere near enough resources to “buy back” affordability in strong markets and address physical needs of properties in weaker markets
- Despite the volume of Y15 activity, we don’t know the outcomes yet – many properties are still in transition

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The Good News

- Unexpected real estate value is threatening long-term affordability, no question
- But it is also brings many benefits in terms of capital
  - Lower perceived risk by investors → higher credit prices
  - More mission-oriented preservation capital is now available
  - Easier for mission-driven buyers to get financing to buy portfolios of owners exiting the business
- Not all the properties that go to market become unaffordable
- Developers can use sale proceeds to create two to three times as many affordable units elsewhere

What is to Be Done?

- Legislative and policy fixes
- Regulators need to use their tools
  - Allocating agencies but also
  - Lenders and subordinate lenders
- Watch those out-years once the tax credit investor is out
  - The pressures on and motivations of owners will be different once the tax credit investor exits
- Lead with the money
  - Provide financial incentives to maintain and extend affordability

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