Latest Developments in Low Income Housing Tax Credits

HOMES WITHIN REACH 2017 CONFERENCE

Presented by:
Mary Dorn, Vice President
Financial Markets

- Financial Market Sector health suggests strong support for the LIHTC market in 2018
- S&P 500 EPS continues to rise but future forecasts are mixed
- Bank earnings continue to rise
- Alternative investment yields remain at historic
- LIHTC and 10-year treasury yield continue to
Factors Affecting Tax Credit Demand

Corporate Earnings S&P 500
Factors Affecting Tax Credit Demand

Corporate Earnings (Average)
10 Large US Banks

Earnings Per Share ($)
Factors Affecting Tax Credit Demand

Alternative Investment Yields

- 10 Yr Treasury
- AAA Corporate
- BBB Corporate
Historical Spreads: LIHTC Yield vs. 10-Year Treasury Rate
Factors Affecting Tax Credit Demand

Alternative Investment Yields

- 10-Year Treasury: 2.15%
- 30-year Treasury: 2.94%
- Agency MBS: 2.95%
- Prime Market Proprietary LIHTC Pre-Tax: 5.78%
- National Multi Fund Pre-Tax LIHTC Pre-Tax: 7.23%
Factors Affecting Tax Credit Demand

Cumulative Default Rates by Years In Service

Totals: AAA=.3%, AA=1.1%, A=3.8%, BBB=7.8%, BB=23.1%, LIHTC=.14%
Equity Market Dynamics

• Uncertain market leads to diverse pricing
• CRA driven market
• Economic Investor’s line in the sand is 5.50-6% minimum yield
• MIF Funds Tiered Pricing allows for both CRA and Non-CRA investors in a fund
• Fannie & Freddie re-enter market
  Duty to Serve
LIHTC Equity Market

2016 Equity Pricing

- Prime Markets: $1.12-1.25
- NY Metro: $1.08-1.23
- Major Urban: $1.05-1.15
- Secondary Northeast: $1.00-1.12
- < $1.00 only for Outliers
LIHTC Equity Market

2017 Equity Pricing

- Prime Markets: $1.02-1.10
- NY Metro: $1.00-1.08
- Major Urban: $0.95-1.02
- Secondary Northeast: $0.90-0.95
- < $0.90 Non-CRA/Rural Markets
Equity Market Dynamics – Tax Reform

• President Trump’s Tax Reform - Lowers Corporate Tax Rate from 35% to 20%

• A Lower Tax Rate Lowers Yields and Pricing
  Drop from 35% to 25% will lower yields for 9% deal by
  126 bps and pricing by 8.5% taking $791MM in Equity
  out of the market

• Novogradac report – “Affordable Rental Housing After Tax Reform” Estimated Impact of these proposed changes
## 9 Percent Property with Boost

### Current Tax Law

<table>
<thead>
<tr>
<th>Tax Rate</th>
<th>$0.95</th>
<th>$1.00</th>
<th>$1.05</th>
<th>$1.10</th>
</tr>
</thead>
<tbody>
<tr>
<td>35%</td>
<td>$0.95</td>
<td>$1.00</td>
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<tr>
<td>28%</td>
<td>$0.89</td>
<td>$0.93</td>
<td>$0.97</td>
<td>$1.02</td>
</tr>
<tr>
<td>25%</td>
<td>$0.86</td>
<td>$0.90</td>
<td>$0.94</td>
<td>$0.99</td>
</tr>
<tr>
<td>20%</td>
<td>$0.83</td>
<td>$0.87</td>
<td>$0.90</td>
<td>$0.94</td>
</tr>
<tr>
<td>15%</td>
<td>$0.80</td>
<td>$0.83</td>
<td>$0.85</td>
<td>$0.90</td>
</tr>
</tbody>
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Assumes 4.5% – 5.0% investor level yield in all scenarios. Results may differ based on a change in underlying assumptions.

Source: Novogradac & Company LLP
4 Percent Tax-Exempt Bond Property with Current Tax Law

<table>
<thead>
<tr>
<th>Tax Rate</th>
<th>Price per Credit</th>
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<td></td>
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<th>Current Law</th>
<th>House Ways and Means</th>
<th>Senate Finance Committee</th>
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<tr>
<td><strong>Volume Cap Low-Income Housing Tax Credits (LIHTC)</strong></td>
<td>Retained</td>
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</tr>
<tr>
<td>$2.35 per capita/$2.71 million small state minimum (2017)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Private Activity Bonds (PAB)</strong></td>
<td>All PAB, including residential rental, <strong>REPEALED</strong> after 2017</td>
<td>All PAB, including residential rental, <strong>Retained</strong></td>
</tr>
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<td>$100 per capita/$305 million small state minimum (2017)</td>
<td></td>
<td></td>
</tr>
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<td><strong>4 Percent PAB LIHTC</strong></td>
<td>4 percent PAB LIHTC <strong>REPEALED</strong> after 2017</td>
<td>4 percent PAB LIHTC <strong>Retained</strong></td>
</tr>
<tr>
<td>$3-4 billion a year</td>
<td></td>
<td></td>
</tr>
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<td><strong>New Markets Tax Credit (NMTC)</strong></td>
<td>2017 round <strong>Retained</strong>, 2018 and 2019 rounds <strong>REPEALED</strong></td>
<td>2017, 2018 and 2019 rounds <strong>Retained</strong></td>
</tr>
<tr>
<td>$3.5 billion annual allocation for 2018 and 2019, 39 percent credit, slated to expire after 2019</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Historic Rehabilitation Tax Credit</strong></td>
<td>Subject to transition rules, <strong>REPEALED</strong> after 2017</td>
<td>20 percent credit <strong>Retained</strong>, but <strong>claimed over 5 years</strong>, after 2017, subject to transition rules</td>
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<td>20 percent credit claimed when property is placed in service</td>
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<td><strong>Corporate Rate</strong></td>
<td>Top corporate rate of <strong>20 percent</strong> starting January 1, 2018</td>
<td>Top corporate rate of <strong>20 percent</strong> starting January 1, 2019</td>
</tr>
<tr>
<td>Top marginal corporate rate of 35 percent</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Property Depreciation</strong></td>
<td><strong>No Changes</strong></td>
<td>MACRS - Residential and nonresidential real property depreciation life reduced to <strong>25 years</strong></td>
</tr>
<tr>
<td>Modified Accelerated Cost Recovery System (MACRS): residential rental real property - 27.5 years; site improvements - 15 years; personal property - 5 years; Alternative Depreciation System (ADS): real property - 40 year</td>
<td></td>
<td>ADS – 30 year cost recovery for real property</td>
</tr>
<tr>
<td><strong>Inflation Factor</strong></td>
<td>Changes to “chained CPI”, future 9 percent LIHTC allocations <strong>REDUCED</strong></td>
<td>Changes to “chained CPI”, future 9 percent LIHTC allocations and volume cap for tax-exempt private activity bonds <strong>REDUCED</strong></td>
</tr>
<tr>
<td>Consumer Price Index for all Urban Consumers (CPI-U)</td>
<td></td>
<td></td>
</tr>
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</table>
Current Trends in LIHTC

• **Rise In Mixed Income & Mixed Use Investment**
  • ** Agencies** – This supports local re-development efforts, expands the population served and preserves subsidy dollars with higher leverage

• **Developers** – This allows them to raise more capital to overcome rising construction costs, creates Operating Efficiencies (more income w/o increased operating costs) and allows them to benefit as MR rents increase

• **Investors** – This increases their risk of default, may fall out of their allowable investment parameters, exposes them to market rate
Current Trends in LIHTC

• **Rising Construction Costs – Cost Containment**

• Regions First Sterling Portfolio

  Non-Urban – Rise of 20% over 5-years & 69% over 10

  Urban – Rise of 25% over 5 years & 48% over 10
Current Trends in LIHTC

• **Supportive Housing Initiatives**
  • State Agencies promoting supportive housing because institutionalizing an individual costs 5x more than housing them in supportive permanent affordable housing

• **Energy Efficiency**
  • Cost savings
  • Trends beginning to be recognized by investors
Current Trends in LIHTC

• Tax Reform Uncertainty
• Corporate tax rate change from anywhere between 20% - 25%
• Investor yields – Moving target
• Private Activity Bonds
  House Bill calls for removal of PAB
  Senate Bill keeps PAB
• Historic tax credit
• Property depreciation
Investment & Pricing Factors

- Sponsor
- Investor
  - CRA vs. Non-CRA
  - Cost of Capital
- Property Metrics
- Policy & Tax Reform

Black Box
Homes Within Reach
2017 Conference

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Latest Developments in LIHTC

Andrew Haines
S & A Homes
December 4, 2017
S & A Family

- S & A Homes, Homebuilder Market Rate homes
- Allied Mechanical & Plumbing
- S & A Affordable Housing, Gatesburg Road Development
- Poole Anderson Construction
  - General Contractor Commercial, Multi Family
Discussion Points

- Tax Reform
- Controlling Construction Costs
  - Examples
  - Trends in Construction Industry
<table>
<thead>
<tr>
<th>Senior</th>
<th>Const Costs (m)</th>
<th>Per SF</th>
<th>PDU (k)</th>
<th>TDC (m)</th>
<th>TDC SF</th>
<th>TDC PDU (k)</th>
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</thead>
<tbody>
<tr>
<td>Highland Hall</td>
<td>$ 10.5</td>
<td>$ 128</td>
<td>$ 199</td>
<td>$ 14.1</td>
<td>$ 171</td>
<td>$ 266</td>
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<tr>
<td>Stonebridge</td>
<td>$ 9.4</td>
<td>$ 150</td>
<td>$ 162</td>
<td>$ 13.2</td>
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<td>$ 219</td>
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<tr>
<td>Homewood</td>
<td>$ 8.6</td>
<td>$ 181</td>
<td>$ 209</td>
<td>$ 11.6</td>
<td>$ 245</td>
<td>$ 282</td>
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<td>Serenity</td>
<td>$ 9.7</td>
<td>$ 156</td>
<td>$ 185</td>
<td>$ 13.1</td>
<td>$ 202</td>
<td>$ 249</td>
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<tr>
<td>URBAN</td>
<td>Const (m)</td>
<td>Per Sf (k)</td>
<td>PDU (k)</td>
<td>TDC (m)</td>
<td>TDC SF</td>
<td>TDC PDU</td>
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</tr>
<tr>
<td>Garfield Glen</td>
<td>$8.9</td>
<td>$139</td>
<td>$197</td>
<td>$12.4</td>
<td>$194</td>
<td>$275</td>
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<tr>
<td>Garfield Glen 2</td>
<td>$4.5</td>
<td>$206</td>
<td>$237</td>
<td>$6.0</td>
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<td>$316</td>
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<tr>
<td>Susquehanna</td>
<td>$9.8</td>
<td>$230</td>
<td>$272</td>
<td>$13.1</td>
<td>$363</td>
<td>$307</td>
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<tr>
<td>Location</td>
<td>Const Costs (m)</td>
<td>Per SF</td>
<td>PDU (K)</td>
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<tr>
<td>Pleasant Hills</td>
<td>$</td>
<td>7.70</td>
<td>$145</td>
<td>$ 194</td>
<td>$ 10.1</td>
<td>$246</td>
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<tr>
<td>Crossroads</td>
<td>$</td>
<td>4.02</td>
<td>$174</td>
<td>$ 211</td>
<td>$ 5.1</td>
<td>$265</td>
</tr>
<tr>
<td>Base SF house with Sitework</td>
<td></td>
<td></td>
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<td>127</td>
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</tbody>
</table>