STCI
Strategic Tax Credit Investments

BEACON HILL CAPITAL

Affordable Housing Equity Market Update

July 14, 2022

Contents:

Friends & Colleagues,

The intent of this newsletter is to provide our investor and syndicator clients a market update with respect to low-income housing tax credit (LIHTC) funds, and to a lesser extent, preservation and workforce housing funds. We use *italics* for text that has been carried forward from previous issues. This makes it easier for regular readers to quickly identify new material while providing important context for readers new to the newsletter, or the industry.

As always, this update is a collaborative effort with our colleagues at Beacon Hill Capital. Together, Strategic Tax Credit Investments and Beacon Hill Capital represent nearly a dozen affordable housing syndicators of various sizes, including both for-profit and non-profit sponsors. Combined, our syndicator partners account for more than 50% of the syndicated LIHTC market. Broad market representation is the foundation of our information-based approach to the brokerage and advisory services we provide, and it is the basis of the commentary that follows.

For LIHTC funds, our primary focus is on multi-investor fund pricing, yields and trends. We also consider pricing across the entire market, including proprietary funds, guaranteed funds, secondary sales, and direct investor activity.

In the context of this newsletter, preservation funds (or naturally occurring affordable housing (NOAH)) and workforce housing funds are non-tax advantaged multi-family real estate equity funds generally comprised of Class B and C properties or developments. Investments in these funds may qualify under Regulation H (12 CFR Part 208) as public welfare investments (PWIs) by targeting low- to moderate-income households, which can help attract equity from CRA investors. These types of funds fall along a spectrum depending upon how oriented they are toward PWI criteria. In terms of portfolio composition, some include a component of new construction workforce housing while others do not.

This issue follows our January 2022 newsletter which, along with previous newsletters, are available on our websites: StrategicTaxCreditInvestments.com and BHCapital.com

We hope you find this update informative and useful. As always, we welcome your questions, comments and perspective.

Summary

There are currently several well-documented global economic headwinds: rapidly rising interest rates, increasing concerns about inflation and the possibility of recession, ongoing supply chain disruption, war in Ukraine, and China's zero-Covid policy. While all of these have contributed to unusual volatility in the capital markets, the affordable housing market, both housing credit and preservation/workforce, has remained relatively steady through the first six months of 2022. Supply and demand remain in equilibrium and pricing and yields have generally been level.

In this issue, we take the opportunity to clear out much of the Covid-related discussion that has been the focus of recent newsletters. The primary lingering impact from the pandemic pertains to ongoing supply chain disruption and labor shortages at state and local agencies all of which result in timing delays. As reported in January, one of the largest syndicators in the industry reported that approximately 20% of their pipeline in 2021 was delayed into 2022.

We have also removed discussion of the proposed housing credit related legislation in the Biden Administration's Build Back Better proposal that could have significantly impacted pricing with additional supply. We now view the probability as very low that any element of this legislation will be passed in 2022.

In lieu of these topics, this edition focuses on a select few matters that could impact demand going forward, such as CRA reform and an update on the proposed Global Minimum Corporate Tax. We have also added commentary on state tax credits, courtesy of Cabretta Capital. Other topics that we have touched on recently, but that we will not delve into here, include HUD income limits and the current state of evictions and rent burden as we emerge from the pandemic. Hyperlinks to Novogradac's site for discussions on both topics can be found below.

https://www.novoco.com/news/novogradac-estimate-income-limits-anticipated-increase-311-average-2023-using-five-year-acs-data

https://www.novoco.com/news/state-nations-housing-2022-report-underscores-ongoing-affordability-crisis

Outlook

Since January, tax credit pricing and investor yields have remained relatively steady with some exceptions. This stability seems to be the result of the balancing of some opposing factors:

- Reduced supply: 12.5% fewer nine-percent credits in 2022 as the four-year boost that began in 2018 expired at the end of last year. In addition, several states forward-allocated credits in 2021 reducing the supply available in 2022.
- Reduced transaction feasibility due to rising interest rates and higher borrowing costs.
- Steady demand: increased demand from the GSEs at least partially offset by reduced demand from some investors concerned about the proposed Global Minimum Corporate Tax.
- Reduced benefits of bridge financing due to rising interest rates, which in turn has put some downward pressure on equity pricing to maintain yields.

Proposed Global Minimum Corporate Tax

The global minimum corporate tax (GMCT) is an effort by the Organization for Economic Cooperation and Development's (OECD) to modernize the corporate tax system. The intent is to better align the tax system with the 21st century economy, where a physical presence of multinational corporations is not needed to generate profits locally. The dual aim of the GMCT is to avoid a race to the bottom among countries with respect to corporate tax rates and to discourage multinational corporations from profit sharing to achieve tax avoidance.

The proposed GMCT is based on two "pillars". The first pillar is to tax companies where goods and services are sold, not where the company is located. The second pillar is to implement a 15% minimum tax on book income. The proposal incentivizes countries to join the agreement by allowing member countries to charge a "top up" tax if a non-member country is taxing companies at a rate below 15%. This is an important element because it also means that large multi-national corporations must consider the GMCT even if the country they are based in does not enact the GMCT. Currently, 140 nations including the U.S. are in support of the proposed GMCT, but ongoing negotiations indicate that potential enactment is likely to slip from 2023 to 2024 at the earliest.

At issue for the tax credit industry specifically is how companies would calculate their consolidated effective tax rate. If tax credits were included in the calculation, it would bring the effective tax rate for many corporations below the proposed 15% minimum threshold, which would require them to pay a top-up tax. That would effectively reduce the value of the credits and negatively impact demand for credits. A preliminary survey indicated a substantial portion of industry investors, perhaps 50%, would be significantly impacted by the GMCT. This concern has been conveyed to the Treasury Department in a letter from a group of 30 national trade associations representing community development credits and financing tools[1].

Currently, there seems to be consensus in the interpretation that equity investments would be excluded from the calculation of consolidated effective tax rate for investors using the equity method of accounting given the pass-through nature of the entities that typically hold the investments. Furthermore, as the Proportional Amortization Method (PAM) of accounting is a subset of the Equity Method, equity investments accounted for with this method would also be excluded from the calculation.

Recent public statements by both the OECD and U.S. Treasury have been supportive of this view and interpretation of the existing accounting rules in the context of the GMCT. According to the Affordable Housing Tax Credit Coalition (AHTCC), Lily Batchelder, Secretary for Tax

[1] https://www.taxcreditcoalition.org/30-national-associations-including-ahtcc-call-on-treasury-to-protect-community-development-credits-on-oecd-model-rules/

Policy, shared last week in remarks to the D.C. Bar Association that the tax policy team at the Treasury Department has been engaging with the OECD to "clarify the treatment of general business credits under the minimum tax." Batchelder said further, "We are confident that the value of many of our general business credits is preserved under the OECD rules, and we have established a process with the OECD for working towards additional clarifications...because of the way those investments are structured and accounted for, the income or loss and the income tax consequences of those investments typically will be excluded from the effective tax rate calculation — so those credits generally should not be impacted."

While the industry is feeling increasingly confident in this interpretation of the accounting based on the positive public commentary, **written implementation guidance from the OECD is needed** on the application of the equity method exclusion interpretation to ensure that all member countries will view these credits in the same way.

Lastly, it is important that we point out that this summary is a simplification of a complex issue, and thus far we only have a basic understanding. If you would like additional information, there are numerous sources on the topic. The link to Novogradac's summary podcast on the topic is included here and they have also published a more in-depth paper on the topic.

https://www.novoco.com/podcast/june-14-2022-global-minimum-tax

Community Reinvestment Act Reform & Modernization

The Community Reinvestment Act, or CRA, became law in 1977 and encourages banks to help meet the credit needs of the entire community in which they do business, with a particular focus on low- and moderate-income communities, consistent with safe and sound operations. The last significant interagency revision to CRA occurred in 1995.

Recently, the three banking regulators; the Federal Reserve Board of Governors (FRB), Office of the Comptroller of the Currency (OCC), and Federal Deposit Insurance Corporation (FDIC), released a joint Notice of Proposed Rulemaking (NPR)[2] to modernize the Community Reinvestment Act (CRA). Public comment is due by August 5th and we are hearing from industry sources that the agencies would like to have the new rules in place by the end of 2022. Any significant changes to CRA regulation could impact the affordable housing industry as equity investment by banks comprise approximately 80% of the market.

Stated goals of the proposed rule changes include:

- Expand access to credit, investment, and basic banking services in low- and moderate-income communities
- Adapt to changes in the banking industry including internet and mobile banking

[2]https://www.federalreserve.gov/consumerscommunities/community-reinvestment-act-proposed-rulemaking.htm

- Provide greater clarity, consistency, and transparency
- Tailor CRA evaluations and data collection to bank size and type
- Maintain a unified approach among the three banking regulatory agencies

In concept, these goals all sound like positive changes, but there are many details within the 680 page interagency proposal that give the affordable housing industry concern. Chief among them is the proposed elimination of the Investment Test, which many banks satisfy in large part by making equity investments in affordable housing. Under existing rules, the Investment Test comprises 25% of a bank's CRA rating. Under the proposed rule, the Investment Test is combined with the Lending Test into a single community development finance test which would comprise 30% of the CRA rating. The industry's primary concern is that this change will reduce banks' incentive to make equity investments and the result could significantly undermine the production of affordable housing in the U.S.

Most banks insist that they make equity investments in housing credits for several reasons beyond CRA requirements including support for all aspects of affordable housing finance, higher rates of return than comparable debt opportunities, tax appetite, and client banking relationships. However, there is concern that smaller banks (i.e. state and regional) may prefer loans due to the increased cost and complexity of underwriting equity investments. There is also concern that smaller banks that haven't yet staffed up to make equity investments may simply make loans instead.

Another concern is the new rules do not provide CRA credit for serving households with incomes above 60% of Area Median Income (AMI). This would make preservation and workforce housing that serve households above 60% AMI, ineligible for CRA credit going forward. As a result, the industry is lobbying to allow for full CRA credit up to 80% of AMI.

There are also some changes that would potentially have other effects on the affordable housing market. First, banking assessment areas would be expanded to include areas of virtual banking activity where they do not have physical branch locations. In addition, CRA eligible activities for a bank's examination purposes would not be geographically restricted to their assessment areas. Both elements should reduce competition among banks in so-called "CRA hot" areas and distribute affordable housing finance activities more evenly across the U.S. In turn, this should lead to a narrower range of housing credit equity prices. On the other hand, the feasibility of transactions and the amount of affordable housing produced in formerly "CRA hot" markets would likely suffer if equity prices declined in those markets. Second, as proposed, the threshold for community development loans would be raised from $2M to $5M. Given the relatively small sizes of affordable housing loans, this would reduce the number of loans that qualify for CRA, and potentially encourage equity investment instead.

Various industry groups will be providing comment to the agencies before the August 5th deadline so it remains to be seen what the final CRA rules will look like. However, so far it sounds like regulators are not inclined to favor any

one industry or product over another and that they believe the housing credit industry will not be disrupted by the proposed rule changes. If CRA rule changes do impact equity investments and housing credits, it seems likely that the new rules will be phased in, and that banks will complete their current CRA cycles under the existing rules. As a result, we expect that any impact will be felt over several years as banks digest the new rules and potentially alter their behavior for future examination cycles.

Income Averaging

Investors have shown limited appetite for transactions using the Average Income Test (AIT) since 2020 when IRS guidance pointed to a "cliff event" risk. Since that time, the industry has been working all channels to get the IRS to respond to industry concerns and provide clarifying guidance.

Recently, Senate Finance Committee Chairman Ron Wyden (D-OR), Ranking Member Mike Crapo (R-ID), Sens. Michael Bennet (D-CO), Todd Young (R-IN), Rob Portman (R-OH), House Ways and Means Chairman Richard Neal (D-MA), Reps. Suzan DelBene (D-WA), Jackie Walorski (R-IN), and Don Beyer (D-VA), sent a letter to the IRS and Treasury urging the expedition of a final rule on income averaging that is "workable and responsive to feedback on the IRS' October 30, 2020 proposed rule." [3]

The current industry expectation is that the IRS will issue a final ruling by end of Q3, so stay tuned.

Below is a summary of the origins of the AIT issue:

Historically, there were two main set-asides with respect to tenant income qualifications, commonly known as the 20-50 and 40-60 tests. The first requires at least 20% of the units in a development are set-aside for households with incomes at or below 50% of AMI, and the second requires at least 40% of the units must be set aside for households with incomes at or below 60% of AMI.

The Average Income Test (AIT) creates a third set-aside option where at least 40% of units are rent restricted. The units can be restricted to AMI levels between 20% and 80% of AMI in increments of 10%, but the average AMI designation for all rent restricted units must be at or below 60% AMI. The intent of this new set-aside was to increase the qualifying household income range and provide flexibility to increase the feasibility of some projects.

In the original two set-asides, if a unit falls out of compliance due to over income tenants, but otherwise complies with the set-aside, the project

[3] https://www.taxcreditcoalition.org/banking-regulators-release-joint-notice-of-proposed-rulemaking-on-cra-reform/

is only at risk of losing the credits associated with the percentage of units that are out of compliance.

The current underwriting challenge for AIT stems from a recent notice of proposed rulemaking from the IRS which lead to concerns regarding potential recapture due to noncompliance. On October 30, 2020, the IRS released a ruling indicating that if an AIT project's average household income exceeds 60% of AMI based on the average of all qualified units, then the project runs the risk of losing all credits allocated to the project. While the IRS included provisions allowing developers to take mitigating actions and amend an AIT project that has fallen out of compliance, this 'cliff event' risk has also resulted in investor pushback and required syndicators to mitigate the risk with underwriting solutions.

Since that time, investors have had a limited appetite for transactions with AIT. LIHTC industry groups have looked very unfavorably on this latest ruling and have submitted comments to the IRS in an attempt to amend the ruling and restore what they see as the original intent of the AIT set-aside.

Properties using the AIT will remain a focus of underwriting until the cliff issue is resolved by the IRS. Until then, underwriting practices that mitigate the risk of a cliff event will continue to be the norm and most funds will limit their exposure to projects using income averaging with many capping their AIT exposure generally below 20% of total equity.

A recent underwriting focus for investors has been properties that elected income averaging, or the Average Income Test (AIT). AIT was established as a new minimum set-aside election for LIHTC projects by The Consolidated Appropriations Act of 2018, but it has been only the last 18-24 months that have we seen projects making this election included in funds.

LIHTC Pricing Outlook

Federal credit pricing at the property level has been flat or down slightly over the last six months while yields to investors have been flat or up slightly over the same period. Despite the significant rise in interest rates, investors have generally not been raising their return requirements, presumably for two main reasons: (1) risk-return profile of affordable housing equity investments are still relatively attractive and, (2) they are looking for volatility to lessen in the capital markets.

In January, we flagged several developments that could upset the current market equilibrium and result in substantial changes to investor yields in 2022. As stated up front, none of those appear likely to happen now and we are instead anticipating the market will likely remain stable through year-end. Current indications are that the Global Minimum Corporate Tax issue will be resolved favorably with respect to accounting treatment of housing credits and other equity investments and any potential impact to demand from CRA reform is likely to take place over several years rather than immediately. A positive resolution of Average Income Test guidance from the IRS is likely later this year which would increase the feasibility of some transactions.

In addition, rising interest rates have reduced the benefits of bridge financing which either compresses syndicator margins or puts downward pressure on pricing as they try to maintain investor yields. Furthermore, any reduction in equity proceeds combined with rising debt costs further reduce the feasibility of development, and thereby the supply of viable transactions.

As always, we emphasize that there is a range in LIHTC yields across the market. Reasons for this include, but are not limited to, differences in portfolio composition, sponsor strength, load, the use of bridge financing as well as inefficiencies in the market.

In general, investors with CRA needs are less price sensitive than non-CRA buyers. CRA pricing can apply to investors who require a CRA letter on individual transactions or groups of transactions depending upon their geographic location. As a result, there is often bifurcated pricing in the market.

While the influence of the non-CRA component of the equity market on lower-tier pricing (property level) is limited because it comprises only about 15-20% of the total market, this segment can still move the market. When non-CRA investors pull back, fund sponsors who rely on non-CRA investor equity will typically cut fees and raise yields as necessary to obtain the investor equity needed to clear their funds. If this pricing pressure persists at the fund level, ultimately lower tier pricing will follow suit.

Our pricing summary focuses on three specific segments: multi-investor national funds; CRA versus non-CRA; and California regional funds. Our pricing outlook for the next six months is based on both fund-level and property-level information from syndicators and investors. It is important to look at both because property-level and fund-level pricing do not always move in concert in the short-term. Historically, there has been a pricing lag of at least six months in the LIHTC market.

Tax credit pricing can be somewhat inelastic due to a number of factors including the long project lifecycle from conception to construction, and the protracted negotiations between syndicators and developers over terms and pricing. There is also a lag in feedback from investor demand to resulting adjustments in property-level negotiations with developers.

National Funds

At this time, national funds seeking to attract economically motivated non-CRA equity are generally priced in the $0.93-$0.99 per credit range on a fully loaded basis with after-tax QIRRs in the 5.75-7.20% range with some exceptions both above and below. The range is little changed from the pricing we reported in January. Yields for the largest, non-CRA investors moved up on the last round of fund offerings as syndicators competed for large anchor investors. With the expiration of additional 9% credits and federal disaster area allocations, as well as reduced feasibility for many transactions, we are assuming that yields will not change materially through year-end and an informal survey of our syndicator partners supports this outlook. For more detailed metrics on current offerings, please see the LIHTC Fund Summary Exhibit C.

In the most competitive CRA areas (e.g. NYC, Boston, Utah, etc.) investors can expect yields to dip into the 3% range for certain transactions. Conversely, some funds are offering yields to CRA investors above 6.00%, depending upon the specific composition of the fund and the syndicator's investor base.

Pricing can fall outside of these ranges based on geographic location of properties, investment size and other special circumstances (e.g. a sponsor replacing a lost equity commitment). At the higher end of the yield spectrum, there are several economic investors that will make larger investments to secure premium yields within national multi-investor funds. We have seen those break point levels increase over the last couple years with the highest returns now typically linked to investment sizes in the $40-50 million range. There are also larger CRA-motivated banks that are making blended investments that mix both CRA selections at lower yields with non-CRA selections to achieve higher overall returns.

Outside mainstream LIHTC multi-investor funds, some investors who require higher returns are willing to invest in funds and projects with higher risk profiles including mixed-income developments, assisted living properties, LIHTC transactions with higher leverage, and locations such as Puerto Rico and other U.S. territories. For example, a prominent syndicator recently launched a U.S. Territory Fund that includes properties in Puerto Rico, USVI and Saipan. The after-tax yield is 10.00% with a fully loaded $0.80 price per credit.

One variable affecting the IRR and price per credit ranges above is the amount of bridge financing being utilized by the fund sponsor. In general, fund bridging becomes more prevalent as interest rates decline and arbitrage opportunities increase. Most national funds assume at least some modest level of bridge financing to manage capital calls, and a number of syndicators use additional bridging to more effectively compete for product and enhance yields. For investors that are focused on the lowest price per credit and little or no bridging, some funds will offer an unbridged investment class option ("cash needs"), which results in a lower IRR.

Conversely, some syndicators offer bridged returns for investors focused on a higher IRR, which generally increases the gross price per credit. These options appeal to different investors based on their internal investment models. It should be noted that the use of bridging by syndicators varies depending on the spread between the cost of bridging and fund yields.

Regional Funds

In 2022, yields for California regional LIHTC funds are generally on par with national fund yields with a mix of CRA geographies that offer lower returns as well as higher returns for non-CRA volume-based investments. Over time, we may begin to see the number of California funds decline slightly or the geographic profile of the funds begin to expand to include other western states as the price disparity between California product and national product remains minimal.

For California market returns more specifically, properties in San Francisco proper still command premium pricing from 3.75%- 4.50%, given the limited number of transactions and high demand. For the greater Bay Area, yields are leveling off

around 5.00%. For Los Angeles, we are also seeing pricing leveling off after spiking to 5.50%-5.75% earlier this year. In smaller metro and rural areas throughout the state, yields are expected to hold steady in the 5.75-6.00% range. Top yields for the largest investors have also risen commensurate with national fund pricing from the low- to high-6% range. While yields have trended up for California over the last several years due to credit supply increases, we may begin to see yields flatten or perhaps even fall now that disaster relief credits have worked through the market. Please see Exhibit D for the California Regional Fund Summary.

Supply

In January, we reviewed key elements of the Build Back Better Act (BBBA) which, if enacted, would have expanded the supply of federal LIHTC substantially. At this point, we are assuming that none of these provisions will be included in any legislation this year. We will refresh our legislative outlook as it relates to LIHTC after the mid-term elections.

As of 2022, the size of the LIHTC equity market is estimated to be about $17.5-19 billion reflecting the decrease associated with the expiration of the 9% credit boost. Furthermore, this estimate of the total size of the market does not reflect the reduced feasibility of many transactions, or the fact that a number of states forward allocated credits in 2021 as previously mentioned. As a result, the effective supply available in 2022 is down by more than just the 12.5% reduction associated with 9% credits.

Please note that for our purposes, the size of the equity market is expressed in terms of investor equity, not total credits. The totals calculated are based on several assumptions and are also subject to any adjustment to price per credit (PPC). PPC can fluctuate significantly due to macro-economic factors and large shifts in supply or demand. For example, prior to tax reform in 2017, PPC at the fund level was in the $1.08 – $1.15 range. Due to the decrease in corporate tax rates, the PPC now sits in the $0.93-$0.99 range (for non-CRA investments), effectively reducing the market capitalization for LIHTC by 10%.

In addition to the expiration of the 12.5% annual increase in federal 9% credits, 100% bonus depreciation is scheduled to be phased out by 2022, and the special LIHTC allocations for Federal Disaster Area relief burn off as well.

Demand

As mentioned in January, Fannie Mae and Freddie Mac increased their annual LIHTC equity budgets from $500M to $850M at the end of last year and they account for most of the increase in investor demand in 2022. There has also some additional demand from a few insurance companies and banks as well. Offsetting some of the increased demand has been reduced appetite a number of investors stemming from the pandemic and concern about the GMCT.

Interest Rate Environment: 10 Year U.S. Treasury and Corporate Bond Rates

As the Federal Reserve tries to tame an inflation rate that reached a 40-year high, several increases to the federal funds rate in the first half of the year with more increases anticipated in the second half, have dramatically impacted rates on alternative investments and borrowing costs. The overnight federal funds rate was at 0.25% one year ago, 1.00% one month ago, and currently stands at 1.75%. Markets are anticipating a further increase of another 125 to 150 basis points through year end potentially bringing it into the 3.0 – 3.5% range. Upcoming meetings of the Federal Open Market Committee (FOMC) are scheduled for the end of July, late September, and early November. As of this week, 100 bps increase to federal funds rate is being contemplated to combat persistently high inflation.[4]

Due to the industry's size and specific characteristics, LIHTC yields do not correlate directly with Treasury yields. However, the U.S. 10-Year Treasury bond rate (10-year) remains a common and important reference point. Over the last six months, the 10-year U.S. Treasury rate has increased 100 basis points or more and has generally fluctuated between 2.75% and 3.30% over the past several months. As we go to press, it is approximately 3.00%

Over the past 15 years, the spread between LIHTC yields (non-CRA yields in national funds) and the 10-year yields (on an after-tax basis) has ranged widely from a low of approximately 135 basis points (bps) in 2006 to a high of around 900 bps in 2010. The historic average has been approximately 470 bps. Using a non-CRA 6.25% after-tax QIRR from the most recent round of closed multi-investor funds, today that spread has dipped below historic average to approximately 388 bps, a change from the favorable spread over the last few years. It is worth noting that although the current spread is below the historic average, there is precedent for the market clearing at similar spreads in the past ten years.

Over the years, a number of investors have indicated that BBB rated corporate bonds may be the best credit proxy for LIHTC investments. The spread between LIHTC yields has also trended favorably against BBB's. Historically, LIHTC yields have been approximately 300 bps over BBB's after-tax equivalent. Currently, BBB's are approximately 5.00% with the resulting after-tax equivalent spread to LIHTC at 230 bps, or about 70 bps below the approximate historical average.

Please see our attached Exhibits A & B for graphical representations of our yield data.

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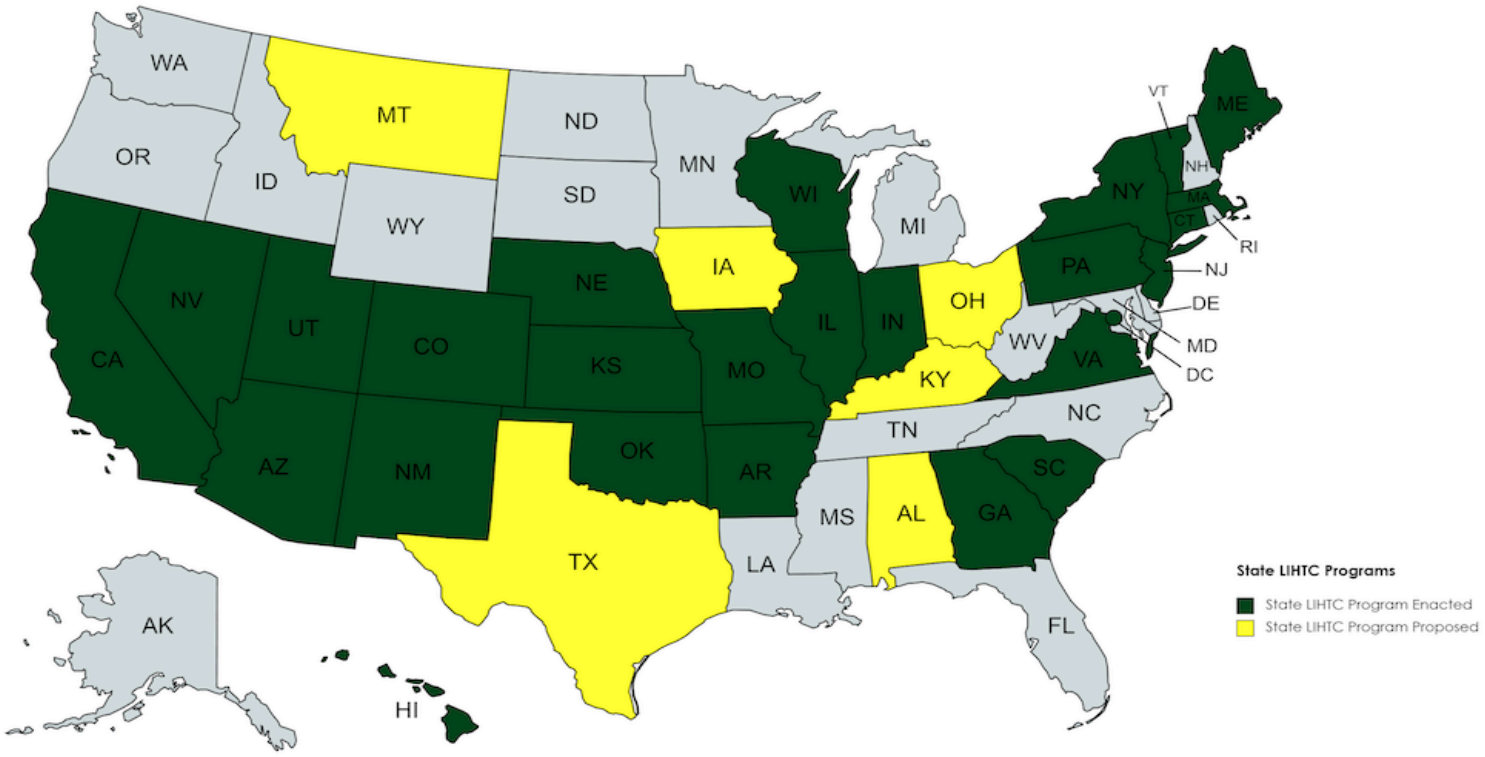
State LIHTC

Due to growing interest from investors in state LIHTC, we've included a summary reference of state LIHTC programs below. Investors often focus on states where the state credit is bifurcatable (can be purchased separately or disproportionally allocated) from the federal credit. States with bifurcatable state LIHTC include: AR, CA, CO, CT, D.C., GA, HI, IL, IN, KS, MA, MO, NM, NY, OK, UT, and VT as well as all of the new programs and proposals mentioned below.

In this issue, we have asked state tax credit syndicator, Cabretta Capital, to provide some additional input and color on the outlook for state credits. Cabretta Capital (cabrettacapital.com) was founded in 2015 by Brent Watts who has been working in the industry for nearly 20 years:

"We are pleased to see state LIHTC programs being enacted and expanded throughout the U.S. in 2022. In the first half of the year Indiana and Kansas enacted new state LIHTC programs that will be coming online soon. Legislation to amend Virginia's 2021-enacted program enjoyed resounding legislative support and as of this writing awaits executive action coming out of this summer. In Texas, groundwork is being laid for an expansive state LIHTC program for their upcoming 2023 session and in Ohio, efforts continue despite significant legislative headwinds. Finally, Iowa and Alabama have seen promising industry-led efforts coalesce as the affordable housing community increasingly looks to this kind of source to shore up deals that have been buffeted by soaring costs and climbing interest rates. The past 10 years have seen a dramatic increase in the enactment of state LIHTC programs as state legislatures and governors increasingly recognize the fundamental importance of providing affordable housing to both maintain and expand their workforces."



Secondary Transactions

Secondary market activity occurs in a few different ways. We think of a traditional secondary sale as when a LIHTC investor simply decides to sell part or all of their portfolio due to reduced need for credits. This happens sporadically and can impact the primary market if the secondary volume is large enough that it reduces a significant amount of demand for primary product.

Alternatively, an investor, typically a bank, may buy and sell LIHTC programmatically. They may purchase more credits than they need as part of meeting their on-going CRA goals and then choose to sell down a portion of their portfolio to free up capacity. Usually this is part of a strategy around banking relationships, securing debt and other CRA opportunities. These transactions are typically bank-to-bank and account for some portion of secondary activity every year.

In 2022, secondary market activity is dominated by a single large offering of about $2.5 billion from one major bank. Such a large secondary would typically create concern around potential impact to pricing in the primary market; however, this secondary is reportedly being offered with a pay-as-you-go structure which produces a very high IRR while eliminating the long investment term that is a key deterrent to some prospective equity investors. While exact details of the offering are unknown, we have heard that investment units are atypically large at $100,000,000 and as a result of the size and structure of the offering that interested investors are generally outside traditional market participants. An initial closing of unknown size is expected later this summer.

Preservation & Workforce Housing Funds

Preservation funds constitute a segment of the multi-family market that is typically comprised of existing, older multi-family rental properties with rents at or below 80% of area median income (AMI) which may or may not have some form of government subsidy, and generally cater to renter households with incomes at or below 80% of median income.

Over the last five years, the number of these funds has proliferated and pricing and terms have started to coalesce. The fund sponsors range from those with stated missions to preserve affordable housing, to those that see value-add plays for older multi-family real estate with strong occupancy and cash flow history.

Interest in the preservation and workforce housing fund sector has continued to grow over the last couple of years as investors continue to look for value in the multifamily sector coupled with an increased corporate focus on social impact investing. As a result of these factors and the establishment of successful track records over the last 5-10 years, the size of the fund offerings continues to increase. Competition from

institutional investors for quality transactions has kept property acquisition competitive and yields from rising despite increasing interest rates. Yields and terms remain largely unchanged over the past 6 months and look to remain stable through year-end, although the proposed CRA rule changes could potentially impact demand over the longer-term.

Like housing credit investments, preservation and workforce funds continue to demonstrate resilience during challenging economic times due to the general shortage of supply and relatively low rent levels. While the overall market for preservation and workforce housing remains stable, there are some reports of transaction-level repricing and investors deferring their closing timeline while they process market gyrations.

Across these sponsors, multi-investor fund sizes range from $100 million to $1.5 billion. Preferred returns have generally been in the 7.00%-8.00% range on a pre-tax basis with total returns in the 10.00%–14.00% range.

Please refer to Exhibit E for our summary of current offerings.

Wrap Up

Please look for our pricing update at the end of Q3 when we send out our updated summary of fund offerings to capture any pricing changes before our next newsletter in January, 2023. Please feel free to contact us with any questions or if you'd like to discuss the LIHTC market and fund offerings in more detail.

As always, we appreciate your feedback and welcome your questions and comments.

You can reach Dave Robbins at 617-340-7040

& Brian Rajotte at 503-575-9232.

StrategicTaxCreditInvestments.com

You can reach Mike Connolly, Chris McCarthy and Garret Daigler of

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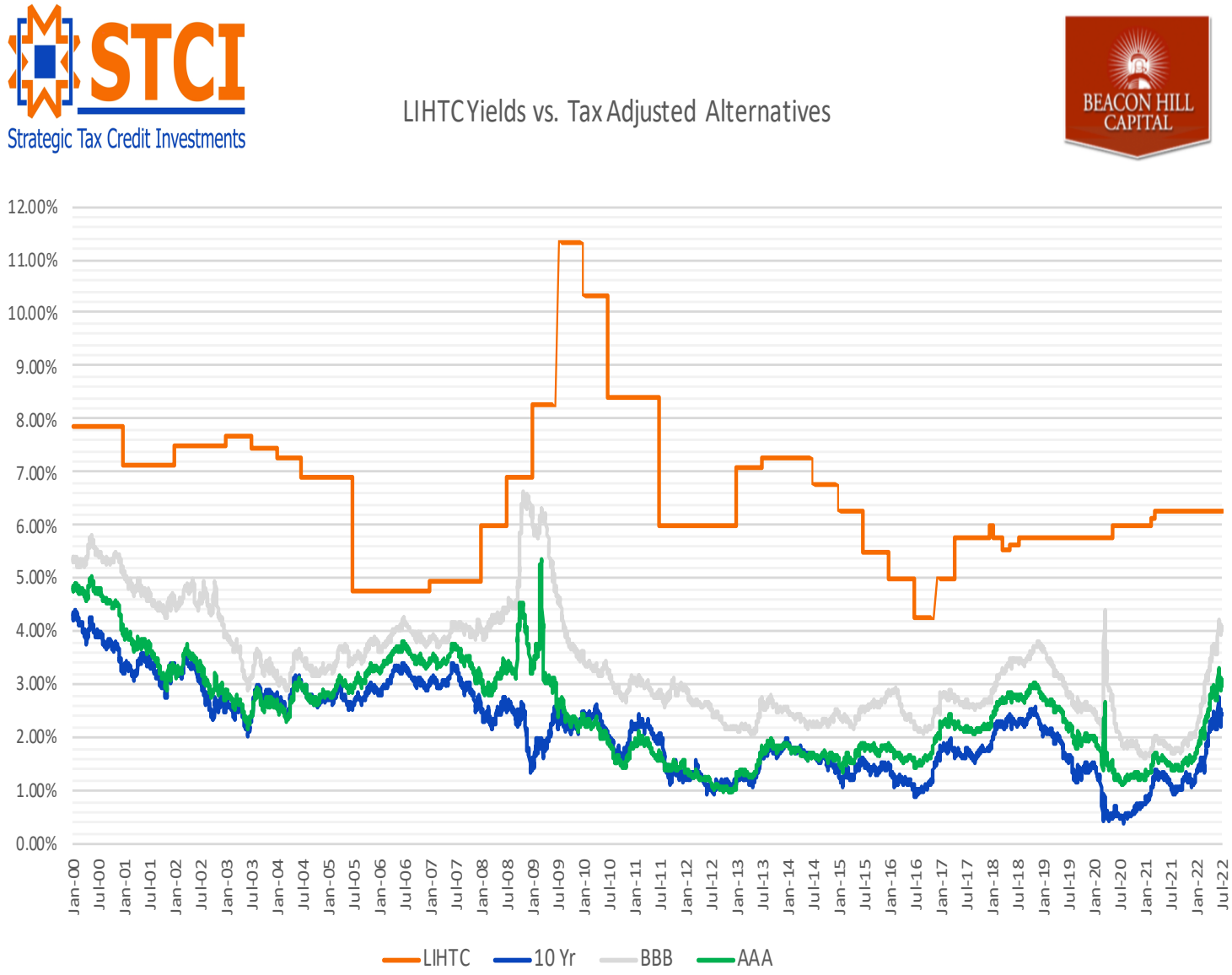
bhcapital.com

LIHTC Yields vs. Alternatives



Notes: 35% Corp. Tax Rate 2000-2017, 25% for 2017, 21% for 2018-present

Avg. LIHTC Yields: informal survey of non-CRA economic sell yields for multi-investor national LIHTC funds on a quarterly effective after tax basis.

AAA, BBB & 10 Yr: Yields adjusted to represent an after tax yield

Source: https://fred.stlouisfed.org/series/

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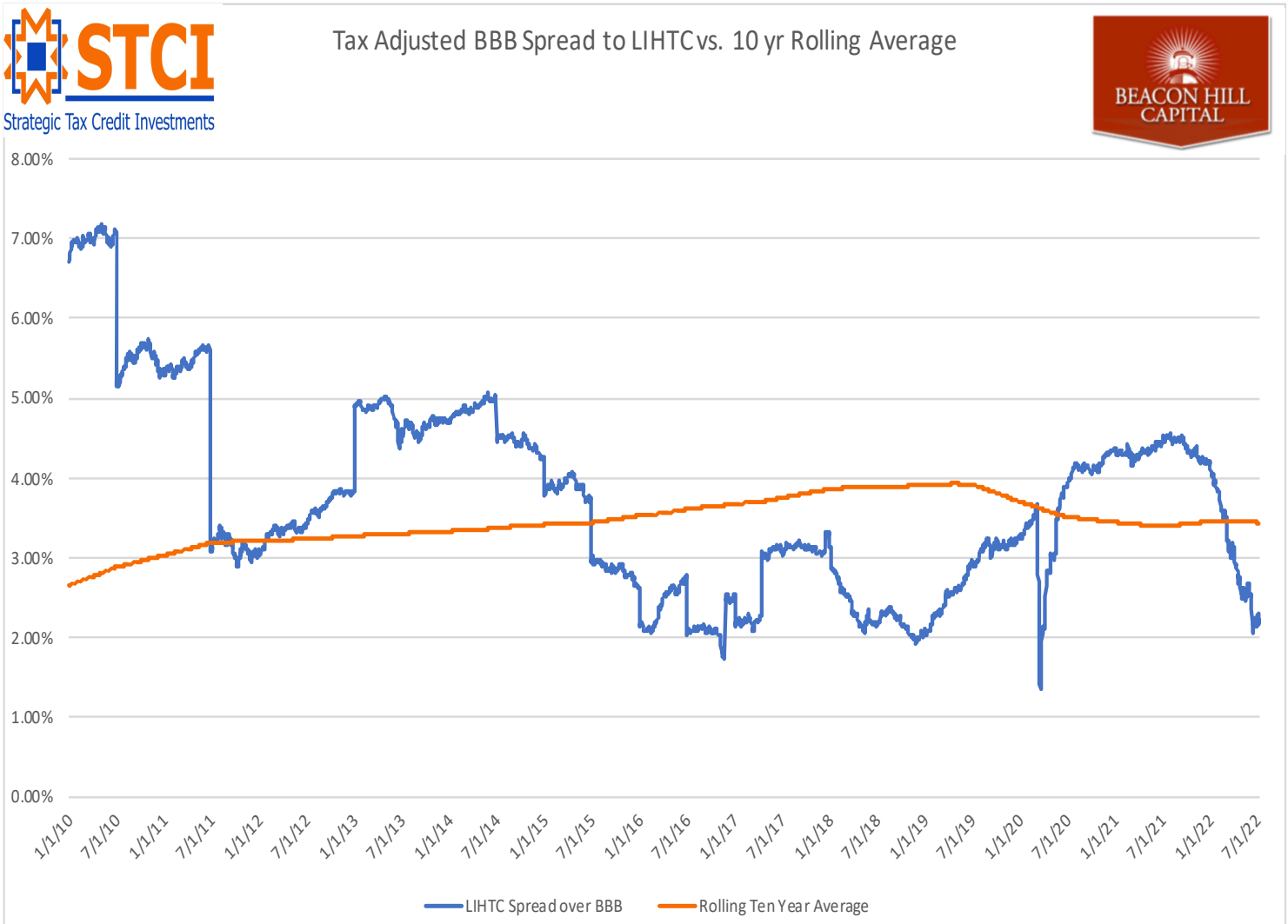
LIHTC Historical Spread Over BBB
10 Year Rolling Average



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LIHTC Market Update: July 2022

An Institutional Division of Compass Securities Corp.

LIHTC Fund Market Overview

Q3 2022

National Funds

Sponsor	Fund	Close	Approx Size ($MM)	Status	Investment Pricing After Tax Quarterly Effective IRR (%) Price Per Credit ($) Investment Class							Hard Debt %	9% / 4%	New Const / Rehab	Loss Ratio	Notes
Alliant	114	Oct	150	Available	7.10% $0.940 >=$50M	6.90% $0.9460 >=$35M	6.75% $0.950 >=$25M	6.40% $0.9599 >=$15M	6.15% $0.967 <$15M	TBD CRA		33%	48% / 52%	78% / 22%	98%	October closing, 11 properties in 9 states, over 85% of properties closed or under LOI, 50% of properties provide resident services such as financial literacy, meal delivery programs, etc.
CREA	91	June	343	Closed	7.25% $0.94 >=$75M	6.85% $0.94 >=$30M	6.60% $0.95 >=$20M	6.10% $0.97 < $20M	5.50% $0.99 CRA I	4.50% $1.03 CRA III	3.75% $1.06 CRA V	33%	46% / 54%	69% / 31%	86%	100% specified, 87% closed or under LOI. 32 properties in 17 states. 76% repeat developer, 31% senior or special needs tenancy.
Enterprise	39	November	300	Preliminary	7.00% $0.920 >=$50M	6.75% N/A >=$35M	6.50% N/A >=$25M	6.25% $0.946 >=$20M	6.00% $0.962 >=$15M	5.75% N/A <=$10	Various Various CRA	23%	37% / 63%	61% / 39%		25 properties, Non-profit, mission focued sponsor
PNC	86	November	175	Preliminary	6.75% TBD >=$35M	6.40% TBD >=$20	6.00% TBD >=$10M	5.75% TBD <$10M	Various TBD CRA			TBD	TBD	TBD	TBD	Accelerated credit delivery due to secondary product, 10% Co-investment by PNC Bank
RBC	34	November	150 - 200	Preliminary	6.75% TBD >=$35M	6.50% TBD >=$25M	6.25% TBD >=$10M	6.00% TBD <$10M	5.00% TBD CRA	4.50% TBD CRA	3.75% TBD CRA	<40%	TBD	TBD	TBD	CRA fund tiers account for majority of equity.
Red Stone	95	June	233	Closed	6.90% $0.931 >=$30M	6.65%* 0.924* >=$30M	6.50% $0.942 >=$20M	6.00% $0.958 >=$10M	5.25% $0.983 < $10M			21%	63% / 37%	68% / 32%	102%	*Cash needs class available for investments above $30M. 24 properties in 12 states. Rental subsidy on 50% of units. 25% senior properties. 67% repeat developer.
Richman	146	September	150	Available	6.00% $0.925 Base			5.25% $0.990 CRA	4.00% $1.020 UT CRA			37%	52% / 48%	76% / 24%	108%	93% repeat developer relationships. Strong CRA markets. . 100% specified, 71% under LOI
Stratford	37	May	170	Closed	6.00% $0.914 cash needs		5.50% N/A CRA		3.75% N/A CRA			33%	50% / 50%	73%/ 27%	100%	15 deals in 9 states. 100% closed or under LOI. No bridging
WNC	53	August	150	Available	6.90% $0.963 >=$35M	6.75% $0.961 >=$25M	6.25% $0.952 <$25M	Various Various CRA				29%	35% / 65%	56% / 44%	96%	14 properties in 14 states. 82% family tenancy. 52% of equity has rental subsidy. No transactions with income averaging. 85% repeat developers.

Loss Ratio: Tax losses before dispoition as a percentage of capital invested

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LIHTC Fund Market Overview

Q3 2022

California Regional Funds

Sponsor	Fund	Close	Approx Size ($MM)	Status	Investment Pricing After Tax Quarterly Effective IRR (%) Price Per Credit ($) Investment Class					Hard Debt %	Notes
CREA	90	June	143	Closed	6.75%	6.50%	6.25%	5.75%	5.00%	29%	6.00% IRR for non-CRA investments of < $20M not shown. 7 properties. 57% LOI or closed. 66% new construction or gut rehab. 84% reepeat developer ratio. 17% senior/special needs. 42% of equity in census tracts >75% minority.
					$0.955	$0.960	$0.970	$0.980	$1.010		
					> $40M	> $30M	>20M	CRA 1	CRA 2		
Enterprise	CAG 8	July	113	Circled	6.35%	6.00%	5.25%	5.00%	4.75%	10%	9 properties. 78% repeat developer. 100% subsidzied and/or senior tenancy.
					$0.940	TBD	TBD	TBD	TBD		
					>=$35M	<=$10M	LA CRA	StocktonCRA	SF/SB CRA		
RBC	CA 8	October	100	Premliminary		6.00%	5.50%	4.50%		TBD	Sand Francisco, Los Angeles, Imperial, Sacramento, Riverside, Kern and Contra Costa Counties.
						TBD	TBD	TBD			
						Base	CRA	CRA			
Red Stone	CA-2022	Oct	125	Available	6.75%	6.40%	5.75%	5.25%		22%	8 properties: 91% specified and closed or under contract; Rental subsidy on 27% of units. 25% senior properties. 70% repeat developer. 100% new construction, and 4% tax exempt bond transactions.
					$0.938	$0.948	$0.967	$0.980			
					>=$30M	>=$20 <$30	>=$10 <$20	<$10M			
WNC	CA 20	July	100	Available	6.50%		6.00%			39%	9 properties located in 7 separate CA markets. 100% specified, $100% under LOI. 68% of equity has rental assitance. 23% senior tenancy. 81% repeat developers. 61% new construction. Low PPC reflects inclusion of state and energy credits and 1% callable upper-tier reserve.
					$0.913		$0.930				
					>$20M		<$20M				

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Market Overview

Q3 2022

Preservation & Workforce Housing Funds											
						Pre-Tax IRR %					
Sponsor	Fund	Close	Commitment Period/Hold (in Yrs)	Asset Mgmt Fees	Approx. Size (millions)	Pref Return	Net/Residual	Co Investment	Minimum Investment Size	Approx. Available $MM	Notes
Alliant	3	2022	3/7	1.5%	100	8.00%	11-14%	2% to 5%	$3M	75.00	2%-5% Alliant Co-investment. Maximim, aggregate fund level leverage of 65%, max of 20% of total fund for a single asset. 50/50 catch-up, 80/20 Promote.
Bridge Investment Group	2	1-Aug	4 / 10-12	1.5-2.0%	1500	7.00%	10-12%	2% up to $10M	$250K	500.00	Circled interest total approx. $1.2B. $650M deployed. PWI compliant, tenant programs & svs, 65-85% acquisition of Class B&C, 10-20% new development, 5-15% manuf. housing. Target leverage of 60-65%.
Enterprise	5	2022-23	3 / 10	1.5%	500	7.00%	9-11%	2.5% <= $2.5M	$500k	300.00	Fully circled. Target returns for CRA investors are 100 basis points lower. Preferred Return of Capital. 50/50 until yields hit, then 20% after preferred return & 30% after net return to LP's thereafter. Max 15% of equity in 1 transaction
PNC	3	2023	3/7	1.25%	100	5%-6%	9%-10%	up to 24.99%	$5M	100.00	Q1 2023 Launch. PNC Bank Co-investment. Leverage of underlying assets of no more thand 65% LTV. Distributions- 100% to investor until 7% annual return, 100% until return of capital, 95% until a non-compounded 11% annual return, 80% thereafter
RBC	1	2022	2 / 7	1.0-1.5%	100	8.00%	10-12%	3% upto $3M	$1M	100.00	PWI Compliant. Target Fund level leverage of 65% to 80%. Max 20% equity in single transaction; 100% of cash flow to investors until pref return and return of capital, then 80/20 split.
WNC	2	2022	3 / 8	1.5%	100	8.00%	11-13%	5% up to $1.5M	$2.5M	25.00	PWI compliant, 100% return of capital to LPs; next 100% to LPs until cumulative 8% pref., 50% to LPs until 20% catch up to GP, then 80/20 split

* Funds **shown in bold** are open to investors.

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