STCI
Strategic Tax Credit Investments

BEACON HILL CAPITAL

Affordable Housing Equity Market Update

January 19, 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 look for 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 July 2021 newsletter which, along with previous newsletters, are available on our website: StrategicTaxCreditInvestments.com.

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

Summary

As we head into 2022, the headline news is the Senate's inability to pass the Biden Administration's Build Back Better legislation before the end of 2021. The proposed legislation included a number of housing provisions that would have resulted in a substantial increase in LIHTC supply, and as a result would have impacted pricing and yields in 2022 and beyond. With the Build Back Better Act (BBBA) dead or delayed due to a threatened "no" vote from Senator Manchin (D-WV), our outlook for the first half of 2022 now assumes a flat pricing and yield trend.

There is still some chance that portions or a scaled down version of the BBBA, could find its way into other legislative vehicles in early 2022. There are rumors of a pared down version of BBBA coming over the next few weeks. Other possible vehicles for the legislation include a federal budget extension (which expires on February 18, 2022), tax extenders package, omnibus appropriations, or an additional federal stimulus package. The options, however, are limited given we are now in a mid-term election year. In this issue, we will revisit key elements of the BBBA and their potential impact to the LIHTC market.

Also making news is the omnipresent pandemic and, specifically, the massive winter surge due to the Omicron variant. As a result, pandemic underwriting protocols remain a focus for investors and related pandemic concerns such as supply chain disruption and timing delays continue for the industry. One of the largest syndicators in the industry reports that approximately 20% of their pipeline in 2021 was delayed due to the pandemic. A primary reason is labor shortages at state and local agency and municipal offices. What was previously a 6-7 month transaction cycle has become 8-9 months. Another syndicator we work with has decided against expanding a fund because of similar pipeline delays. Reduced staff levels in state and local offices also raises real questions about the ability to deliver additional credits, bond allocations, and soft money even if some of the provisions of BBBA are enacted later this year.

Lastly, we welcome the release of the latest LIHTC industry performance report, Cohn Reznick's Affordable Housing Credit Study, the 9th edition in the series. This bi-annual industry review is an invaluable resource for understanding the operating and investment performance of the LIHTC asset class and it continues to improve with each edition. This report includes the largest sample size and most in-depth analysis of the industry to date and we will summarize some of the key points.

www.cohnreznick.com/insights/affordable-housing-tax-credit-study-report-2021

Outlook

Since July, yields have been trending gradually upwards, but are generally holding steady in the more competitive CRA markets. One factor contributing to the upward trend in yields over the last several years has been the 12.5% annual increase in 9% credits that was passed in an Omnibus Appropriation Bill in 2018 and expired at the end of 2021. With the BBBA on hold, this year's supply of 9% credits will actually decline from 2021 levels if Congress is unable to extend that provision.

In our previous newsletter, we highlighted several topics to keep an eye on that could impact the LIHTC market. The outlook for some of them has changed dramatically.

- Corporate tax rates: We highlighted the possibility of higher corporate tax rates in 2021. Any rate change is now unlikely in 2022.
- Supply: Instead of the potential for a significant expansion, a limited contraction (12.5% fewer 9% credits) is now likely unless this element of the BBBA is passed through an alternative legislative vehicle.
- Demand: Gradually increasing. LIHTC equity investment budgets of Fannie Mae and Freddie Mac increased a combined $700M in the second half of 2021, as well as the entry or return of several new and dormant investors.
- Underwriting: Income Averaging guidance is still pending, and pandemic-related elevated construction costs, labor shortages, and supply chain issues remain key considerations.

The affordable housing industry, and the market for LIHTC investments specifically, continues to demonstrate resiliency in times of economic distress. It has weathered the COVID-19 global pandemic well, albeit with massive amounts of federal fiscal stimulus coupled with eviction moratoriums.

Affordable housing fundamentals remain strong with tenant demand for quality affordable housing far exceeding supply. Investor benefits based on tax credits and tax deductions, rather than cash flow and operations, remain relatively steady unless operational challenges persist for several years in a row.

Last year we highlighted a concern with respect to state budget deficits and the potential impact to affordable housing. State and local governments often contribute to the financing of affordable housing at the project level, closing funding gaps with sources such as grants, TIF loans, real estate tax abatements, etc. Many states also have their own state level Low Income Housing and Historic Preservation Tax Credit programs. Thanks to the massive federal stimulus and higher than projected revenues, however, nearly two dozen states realized budget surpluses in 2021. Nonetheless, it seems that some of the surpluses are now being gradually absorbed by the surging pandemic.

LIHTC Pricing Outlook

The so-called "4% Fix" which was part of the Consolidated Appropriations Act of 2021 effectively increased the supply of 4% credits associated with tax-exempt bond transactions. In conjunction with the 12.5% annual increase in 9% credits from 2018-2021, and a slight reduction in investor demand during 2020 and 2021, LIHTC yields have been on an upward trend over the past few years.

Federal credit pricing generally trended downward during 2021 resulting in an upward trend in investor yields. Pricing in higher demand CRA areas has remained relatively stable with the exception being California where even high demand metro areas have seen rising investor yields due to significant increases in the supply of state and federal disaster credits. As investors increasingly focused on pandemic-related underwriting concerns, there has been a "flight to quality" which contributed to higher pricing for the best transactions, while we saw lower pricing for less desirable projects.

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 the non-CRA component of the equity market has on lower-tier pricing (property level) is limited because it comprises only about 15-20% of the total market, this segment can 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 $0.92-$0.99 per credit range on a fully loaded basis with after-tax QIRRs in the 6.00-7.00% range with some exceptions both above and below this range. This represents an improvement to the pricing we reported in July with price per credit generally down 2-3 cents and yields up 40-50 basis points over the course of 2021, but stabilizing late in the year. Yields for the largest, non-CRA investors moved up on the last round of fund offerings as syndicators competed for large investors who still had some remaining allocation to invest. With the BBBA legislation stalled, the expiration of additional 9% credits from and federal disaster area allocations, as well as gradually increasing demand, we are assuming that yields will hold steady during the first half of 2022.

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 a number of economic investors that will make larger investments to secure premium yields within national multi-investor funds. 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. Currently, we see a limited number of opportunistic offerings ranging from 7.2% to over 10.00% on an after-tax basis.

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 became more prevalent as interest rates have declined and arbitrage opportunities have increased. 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, enhance yield and manage investor capital contributions. 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. It should also be noted that while pre-COVID interest rates were at a record low, some lenders have since increased those rates and required additional underwriting and internal approvals during the pandemic.*

California Regional Funds

Over the last few years, we have reported on the trend of rising yields for California regional funds due to continued increases in the supply of both federal and CA state credits combined with relatively steady demand. California LIHTC supply increased markedly since 2019 from its previous annual benchmark of roughly $2.5B. The CA Assembly Bill 101 and COVID relief bills added $500M of state tax credits and roughly $1.1B of federal credits for the 2020 allocation year for disaster relief from the 2018 wildfires. Additionally, CA received another $80M in disaster relief credits for the 2021 allocation year ($800M over 10 yrs) as a result of the COVID relief package signed in December of 2020.

In 2021, yields for CA LIHTC funds roughly approximated national fund yields. Properties in San Francisco proper will still command premium pricing from 3.50%- 4.25%, given the limited number of transactions & high demand. While still commanding a price premium, in the greater Bay Area, we have seen yields as high as 5.00%. Yields continue to rise to the mid 5% range in Los Angeles and San Diego. In smaller metro and rural areas throughout the state, yields should hold steady in the 5.75-6.50% 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 somewhat in the second half of 2022 with the ‘20 & ‘21 disaster relief credits having worked through the market.

Underwriting

The pandemic continues to impact underwriting so we will review various underwriting challenges discussed in previous newsletters and add new information where appropriate.

As a result of the pandemic, all of our syndicator partners have adjusted their policies and procedures with respect to underwriting new transactions and reporting on existing portfolios. New construction and rehabilitation of existing projects has not been as negatively impacted as initially feared at the onset of the pandemic. Some syndicators have added three months to all construction, lease-up and credit delivery schedules, others are running stress tests that reflect 3-6 month delays, and others are evaluating timelines on a transaction-by-transaction basis. Still as discussed above, syndicators are generally experiencing delays of two to three months for various reason in closing on property-level transactions.

Portfolio Composition

The pandemic has created some shifts in investor preferences with respect to fund portfolio composition, some of which are counter to historical trends.

For example, the focus on subsidy appropriation risk seems to have shifted to favor subsidized units as investors feel more comfortable with properties receiving government supported rental payments.

Small and rural markets, which have generally been impacted less by the virus, with some notable exceptions, have become more attractive to some investors. Senior properties, characterized predominately by tenants on fixed incomes, have been posting slightly better rent collections. Conversely, senior tenants are both much more at risk to the Coronavirus and are a more sensitive population with respect to conducting rehabilitations with tenants in place.

Investor sentiment seems split with respect to new construction versus rehabilitations. There is still solid demand for clean transactions that adhere closely to underwriting guidelines, but transactions with underwriting challenges are finding little traction.

Rent Collections & Eviction Moratorium

During the first year of the pandemic, we consistently saw initial monthly rent collections range from 85-95% of historic averages across a range of syndicators and full month collections within a few percentage points compared to the same months in the prior year for both LIHTC and preservation/workforce housing. While all syndicators were providing additional reporting with respect to rent collections during 2020, most stopped providing supplemental reporting during 2021 as significantly reduced rent collections never materialized. With the recent COVID surge due to the winter season and the Omicron variant, we may again see some additional focus and reporting on this aspect of operations until the current wave recedes. Again, with respect to LIHTC property operations specifically, investor benefits consisting of tax credits and tax losses are historically insulated from short-term changes in property operations.

The national eviction moratorium was extended several times during the pandemic, but finally expired on July 31, 2021. A survey of our syndicator partners indicates that they did see some increased eviction activity late in 2021, but not to the point that it impacted property operations or occupancy levels materially. With the economy continuing to post strong economic growth and many states still flush with federal stimulus funds that can be used to help households in need pay past due rent and utility bills, we expect mass evictions will continue to be avoided.

Area Median Income Trends

Area median income (AMI) projections have also become a concern. AMI governs maximum allowable LIHTC rents, and the concern is that the pandemic's deep impact on employment may result in flat or negative AMI trends in some markets. It is something to watch with respect to pro forma rent growth assumptions and operations of existing portfolios. It is also important to highlight there is a three-year lag on income data. The AMI of today is based on income data from three years ago. Therefore, any impact to AMI from the pandemic will not show up until 2023-2024. It is possible that increasing inflation, as a result of pandemic-related federal stimulus, may be a mitigating factor to a decline in AMI as well as encouraging signs of wage growth at the lower end of the income spectrum as many service industries compete for new applicants.

Income Averaging

A more 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 only recently have we seen projects making this election included in funds.

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 have to be set aside for households with incomes at or below 60% of AMI.

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 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.

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. We anticipate seeing increased scrutiny on AIT projects and will keep an eye on future developments in regards to the latest ruling.

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 between 0% and 20% of total equity.

Some industry insiders believe the IRS may issue guidance likely pulling back the proposed rulemaking within the next few weeks. While this rumor sounds promising, the actual impact to AIT LIHTC projects will only be known if and when that guidance is published.

Building Costs & Supply Chain Disruption

Developers have enjoyed increased supply of financial resources available to build LIHTC projects, however, they have encountered new challenges as the economy continues to feel the effects of the pandemic. LIHTC development has been slowed due to factors that have plagued the construction industry as a whole.

As noted in previous newsletters, when many building sectors were stalled or under a moratorium due to the pandemic, affordable housing construction generally was exempted. LIHTC production still faced many challenges however; rising materials costs, labor shortages and COVID protocols slowed the building process for affordable housing. Bottlenecks at state agencies & HUD have also delayed the pipeline of LIHTC projects.

At the local level, many municipalities have experienced logjams for approvals. It is often reported that a process which has historically taken 2-3 months now is taking double that time. Larger and more sophisticated LIHTC developers have actively taken steps to mitigate this delay, but smaller developers are feeling the brunt of this impact. Larger developers also often have more leverage over subcontractors that are in high demand, given they often have several projects lined up simultaneously.

The IRS has provided some relief with many LIHTC deadline extensions and other regulatory accommodations designed to soften the impact of pandemic related issues. Many of these technical provisions are timing related at the deal level minimizing the pandemic's impact on closing timelines & credit delivery. Please follow the link for more detail: https://aboutbtax.com/1cw

Building supply costs have increased across the board, but the most notable item over the last year has been the dramatic increase in lumber prices. Most new construction LIHTC projects are very sensitive to lumber prices, as many are wood frame, low-rise buildings. This increase left many LIHTC developers scrambling for strategies to minimize cost increases that may ultimately leave budget gaps and threaten financing. Lumber prices began rising during the summer of 2020, peaking in late September, then steadily rising again over the first half of 2021. Prices came down in the fall, of '21 but have been climbing steadily higher through the winter. Factors resulting from climate change, supply chain issues, and increased demand have compounded lumber price increases. The recent uptick in lumber prices is another data point reaffirming our current inflationary period.

Please see the chart illustrating the data. Random Length Lumber Futures (LBS=F: https://finance.yahoo.com/quote/LBS%3DF/history/

Looking Ahead

In July of last year, we flagged several developments that could upset the current market equilibrium and result in substantial changes to investor yields in 2022. As stated in our summary, none of those appear likely to happen now and we are instead anticipating the market will remain relatively stable in the near-term. Still, it is important to revisit these potential impacts to the market and discuss their future likelihood.

Components of the Biden Administration's FY 2022 budget request included increasing the corporate tax rate from 21% to 28%, increasing the global minimum tax from 10.5% to 21%, instituting a 15% minimum "book" tax for large corporations and replacing the BEAT tax with SHIELD (Stopping Harmful Inversions and Ending Low-Tax Developments).

There have been questions on the proposed 15% minimum tax on book income for corporations. This tax was originally proposed to apply to companies with revenues exceeding $100 million, but that has since been increased to $2 billion. Treasury estimates roughly 180 firms would meet the income threshold and 45 would owe minimum tax liability. As proposed, business credits, including LIHTC, will be able to offset this book tax. While the likelihood and details of this tax are in flux, the implementation of this tax could potentially increase the pool of interested institutional investors in the market. Some or all of these budget components remain a concern for some investors.

Supply

If some or all of the provisions of the BBBA make their way into the federal budget this year, it is likely that the supply of LIHTC will increase substantially and pricing will have to reset. The affordable housing elements of the BBBA are similar to elements of the Affordable Housing Credit Improvement Act (AHCIA), parts of which were enacted in 2019, which was co-sponsored by more than 40% of all members of the 115th Congress and had strong bipartisan support in both the Senate and House. The program is particularly attractive coming out of the pandemic given the high rent burden of many Americans. In addition to the jobs that would be created by expanding the housing credit program, support for the program is also enhanced by the understanding that quality, affordable housing is the foundation of families' financial, physical and mental health.

In 2021, the size of the LIHTC equity market is estimated to be about $19-20 billion, comprised of roughly 47% 9% credits and 53% 4% tax-exempt bonds. This is a $2-3 billion increase resulting from the 4% Fix previously discussed.

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 a number of 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 $0.92-$1.00 range, effectively reducing the market capitalization for LIHTC by 10%.

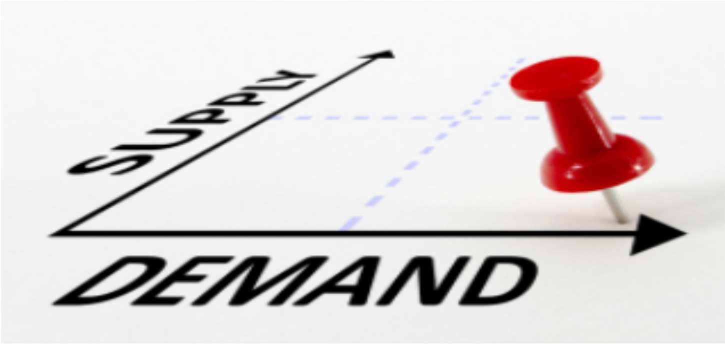
Here are the key components of the BBBA and what their impact would be on the LIHTC market both individually and collectively:

- Currently, projects receiving 4% LIHTC must be financed with at least 50% Tax Exempt Bonds, one proposal is to lower the bond-financing threshold from 50 percent to 25 percent for five years, from 2021 to 2026. Effectively doubling the efficiency of the PAB allocated and increasing the overall supply of LIHTC, particularly in states that have been hitting their allocation caps.

- Increase the annual 9% Housing Credit allocation at a rate of 10 percent per year plus inflation from 2022 to 2024, which amounts to a roughly 41% increase (approx. $3 billion per year over three years) over current levels in 2024, followed by inflation adjustments after 2025.

- Provide a permanent 50% basis boost for properties serving extremely low-income (ELI) households. The basis boost provision would increase the feasibility of many projects as well as the overall supply of LIHTCs.

- Provide a permanent 30% basis boost for properties in Indian Areas.



It is safe to assume that a dramatic increase in supply of LIHTC would be met, at least initially, with insufficient demand and a corresponding downward pricing adjustment. Over time, the market would return to equilibrium and the resulting impact to overall market capitalization would become clearer as well. It is also important to note that any significant increase in supply would take considerable time to deploy, perhaps 6 to 18 months, a task made all the more challenging by the staffing shortages and bottlenecks previously mentioned.

In the absence of these expansion provisions, there are several components which result in decreased supply and/or reduced demand. In addition to the expiration of the 12.5% annual increase in federal 9% credits, 100% bonus depreciation in 2021 is scheduled to be phased out by 2022, and the special LIHTC allocations for Federal Disaster Area relief burn off as well.

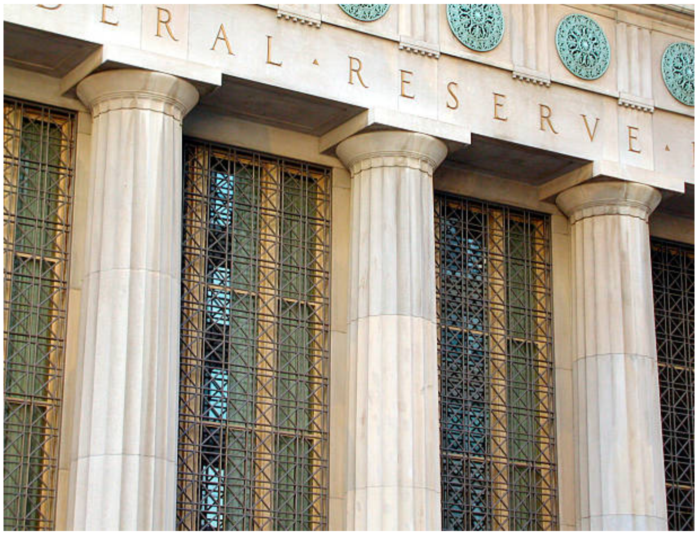
Demand

Since their return to LIHTC equity investing, Fannie Mae and Freddie Mac have accounted for about 5% of the LIHTC market. In July, we projected that their LIHTC equity investment budgets may double in size after the Biden Administration replaced the Director of the Federal Housing Finance Agency (FHFA). In the second half of 2021, their respective budgets did increase from $500M to $850M annually (70% increase), but not the doubling we anticipated. Fannie and Freddie will still amount to less than 10% of the LIHTC equity market even if their budgets increase to $1 billion annually. In contrast, the GSEs accounted for 35-40% of the equity market before the financial crisis in 2008. It is also important to note that both organizations are likely to need to increase staffing levels to deploy these larger budgets.

Several large insurance companies returned to the equity market in 2021 and together represent an additional $500 million per year or more. One had been investing approximately $300 million annually in LIHTC, but paused new investments during the pandemic. As expected, they returned to the market in late 2021, although at about 50% of their previous volume. A second major insurance company has returned to the market after a more than five-year hiatus. They made $200M of commitments in Q4 2021 and are expected to invest a similar level of equity in 2022 and 2023. We've also seen a new entrant to the market recently and expect that their investment levels will increase in 2022 and beyond. We also see additional potential demand from several others and part of that may be driven by Environmental, Social, and Governance (ESG) initiatives.

Interest Rate Environment: 10-Year U.S. Treasury & Corporate Bonds

The Federal Reserve has been committed to doing whatever is necessary to support the economy through the pandemic and the response to COVID-19 has been historic. The overnight federal funds rate remains at its record low range of 0.0%-0.25%, which has helped buoy the stock market despite the pandemic's initial impact on the economy. The next Federal Open Market Committee (FOMC) meeting and decision on short-term interest rates will be on January 26, 2022. The Fed has signaled that it intends to begin raising short-term rates in 2022, perhaps as early as March, with at least three rate increases expected to counter inflation concerns. Market expectations are reflected in the increase on the 10-year treasury rates since our last update in July, from roughly 1.20% to 1.86%.



The debate continues between those who regard the current spike in consumer pricing as transitory, and those who believe that it will be permanent. According to Bob Brinker's Marketimer December issue, "There are indications that the peak in inflation pressure will be reached by the upcoming winter season. Shipping prices have declined since reaching their peak in September when the price to ship a 40-foot container exceeded $10,000, over seven times the cost during the 2017-19 period. The Baltic Dry Index, which tracks the cost of dry bulk items such as coal, iron ore, and grains, fell over 50% from October to November. We expect 2021 to mark the peak year of inflation data for the pandemic." bobbrinker.com

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. While yields on the 10-year moved both up and down during 2021, the trend has been upward due to long-term inflation fears as a result of government stimulus, labor and supply chain shortages. Currently, 10-year treasury yields are approximately 1.86%, up about 70 basis points in the past 12 months. Despite this rise, the spread to LIHTC investments has remained above the long-term historic average as LIHTC yields have also trended up.

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 bps in 2006 to a high of around 900 bps in 2010. The historic average has been approximately 450 bps. Using a non-CRA 6.25% after-tax QIRR from the most recent round of closed multi-investor funds, today that spread is still slightly above historic norms at approximately 478 bps.

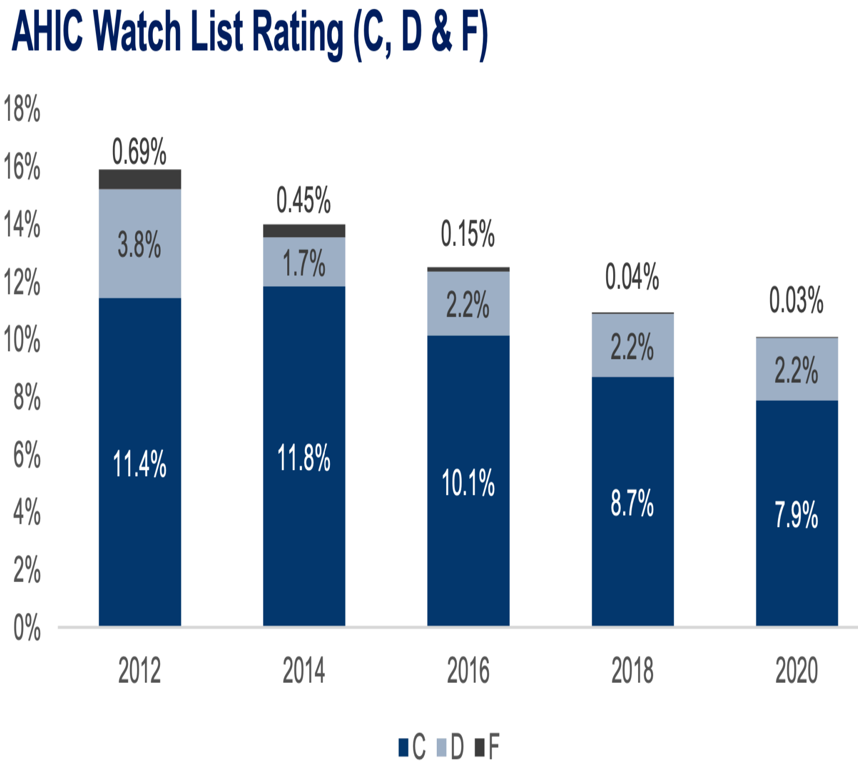
Over the years, a number of investors have indicated that BBB rated corporate bonds may be the best credit proxy for LIHTC investments. The spread between LIHTC yields has also trended favorably against BBB's. Historically, LIHTC yields have been approximately 330 bps over BBB's after-tax equivalent. Back in March of 2020, the BBB index spiked to around 5.50%, but after the Federal Reserve Board's (FRB) actions stabilized market liquidity issues, BBB's returned to their downward trend. As of January 18, 2022, BBB's have risen to 2.785%, the resulting after-tax equivalent spread to LIHTC sits at 400 bps, above historical norms.

Please see our attached exhibits for graphical representations of our yield data.

Latest Industry Investment Performance & Operations Report

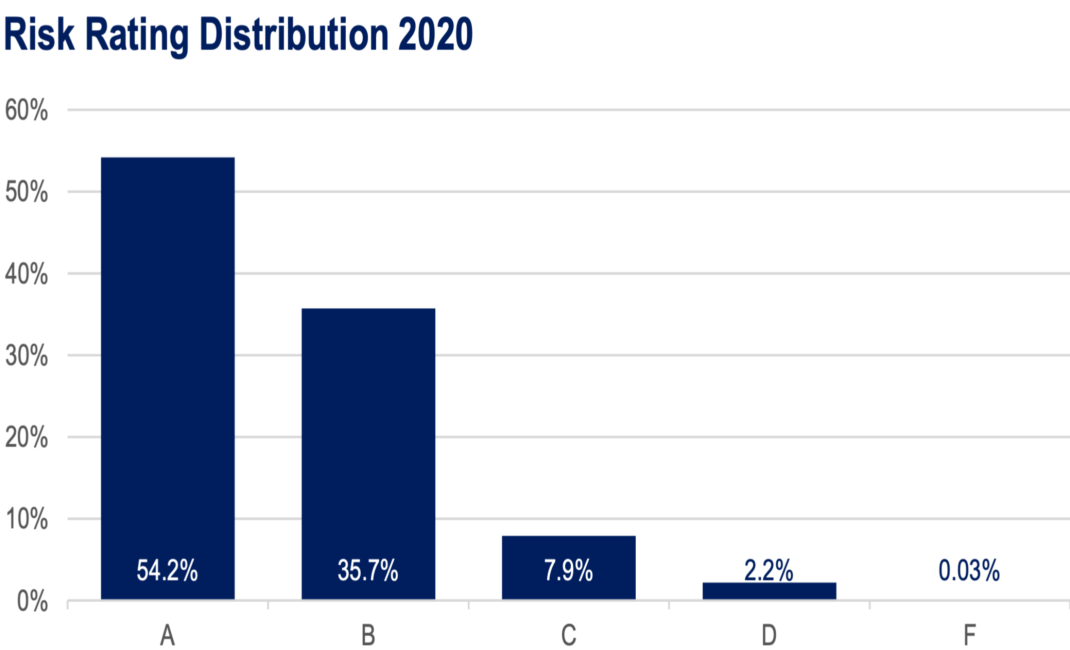
Cohn Reznick released the 9th edition of its LIHTC industry performance study in November, 2021. This bi-annual industry report is an invaluable resource for understanding the operating and investment performance of the LIHTC asset class and continues to improve and build on the quality of the analysis in each edition.

As cited in the report, the Section 42 program has produced more than 3.5 million affordable rental units in the U.S. since the program's inception and the data set includes more than 30,000 properties. Cohn Reznick estimates the LIHTC market totaled $18.4B in 2020 and 73% of the equity came from CRA investors. Fifty-five percent of the properties were in multi-investor funds, 43% in single-investor, or proprietary funds, and 1.4% were in guaranteed, or credit enhanced funds.



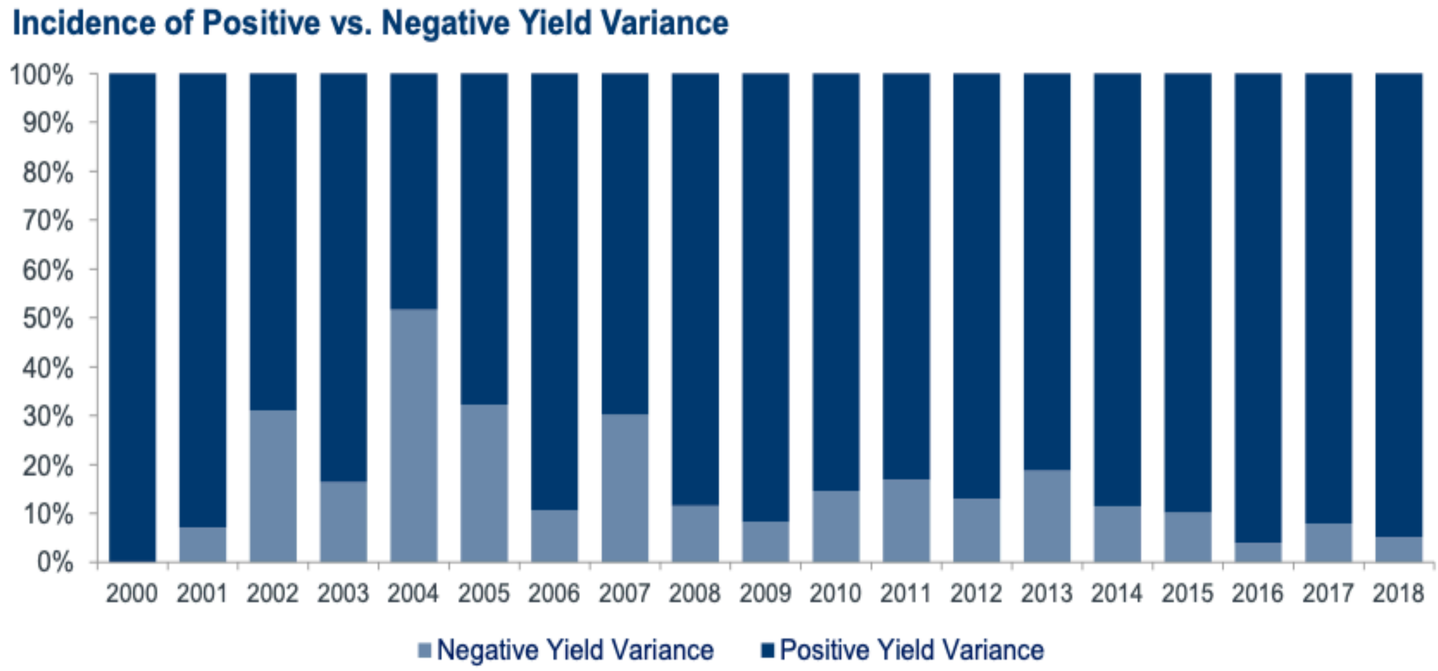
The data is as of year-end 2020, so this report also reflects the impact from the pandemic through 2020. As the report runs 97 pages *before* the appendix, we wanted to hit some of the highlights.

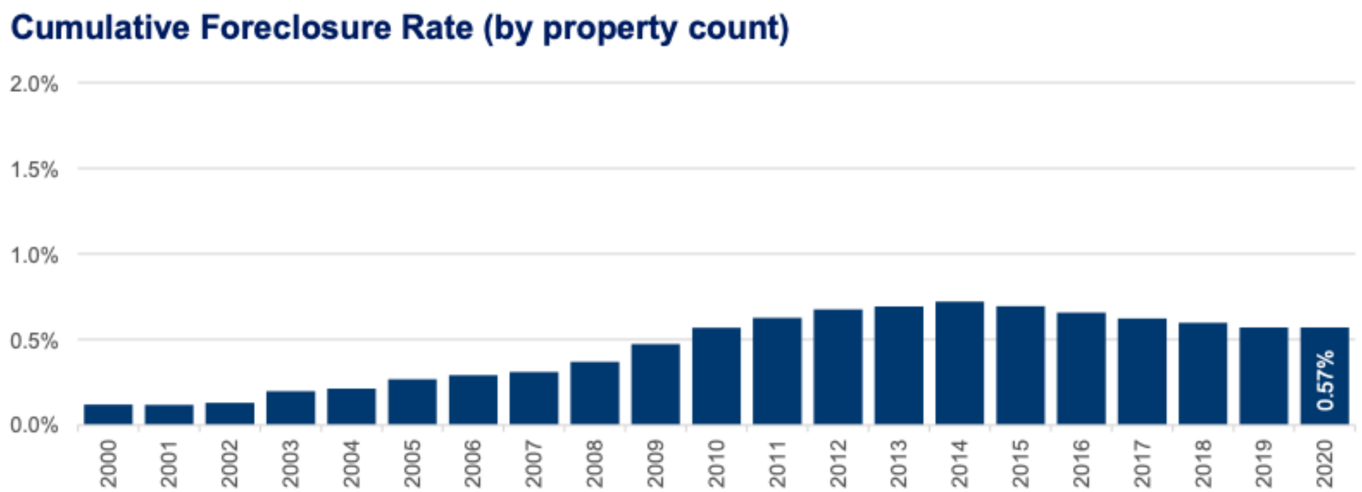
From our point of view, the overriding takeaway is that the risk-return ratio of the asset class continues to improve. The performance of the asset class has always been exceptional, but common underwriting standards and the evolution of industry best practices continue to drive down the cumulative foreclosure rate, and watch list ratings while operating metrics have continued to improve.



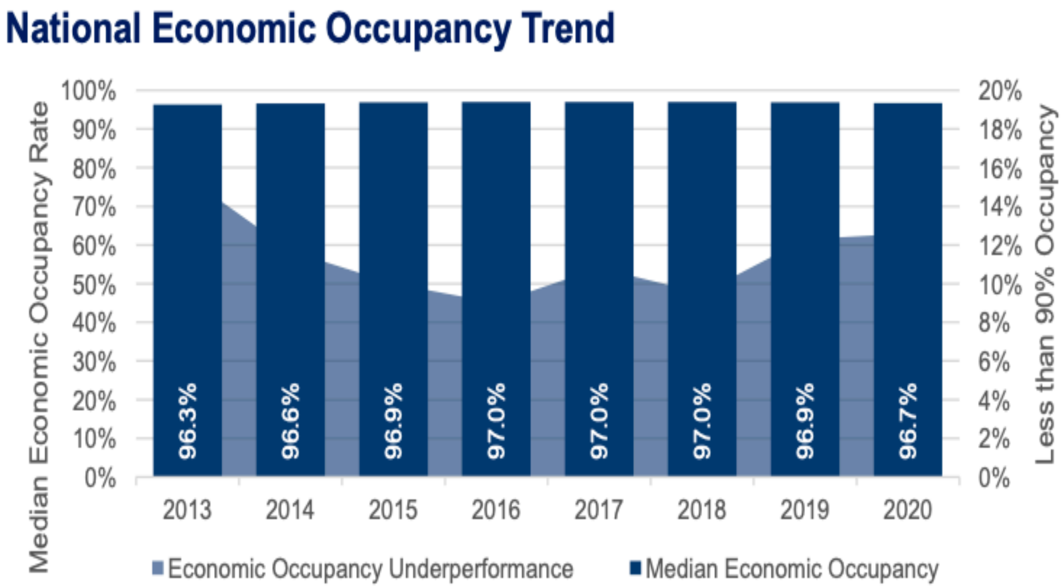
Across the report's very large sample, properties are delivering 99.6% of projected IRR. The report also finds that 95% of properties have had a positive total credit variance and that the rate of positive variance has been improving over the last 10 years. Only 5% of all properties reported a negative total credit variance. Furthermore, the magnitude of negative credit variance is 5% or less of total credits for more than 90% of those properties with a negative credit variance.

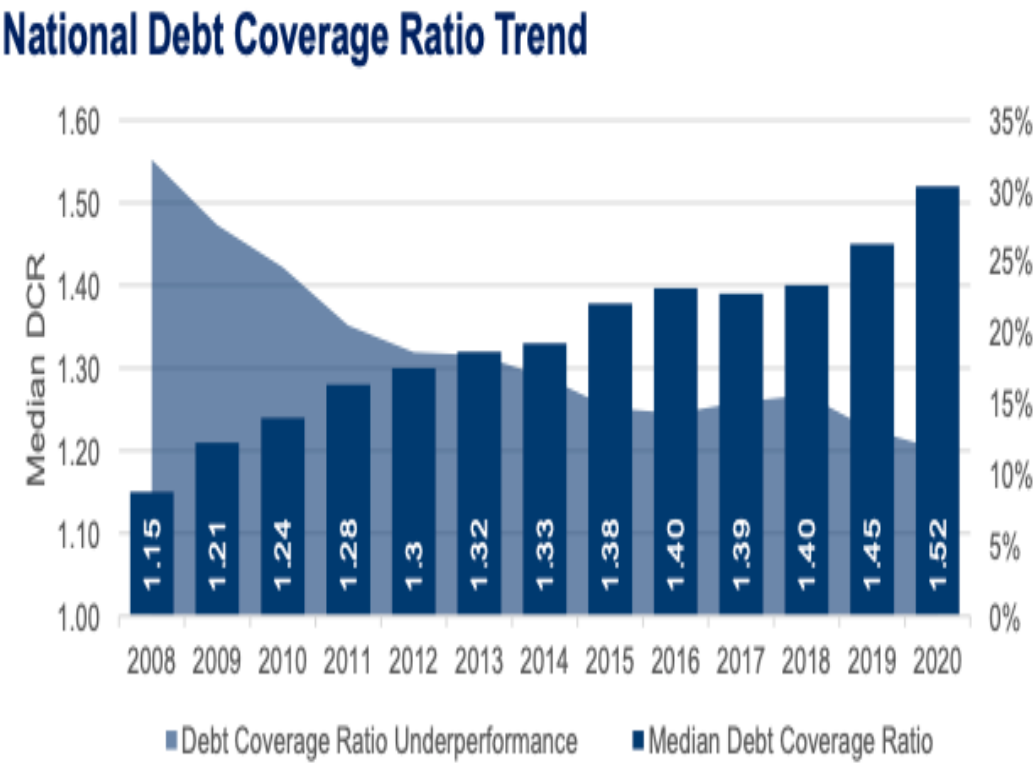
The reported cumulative foreclosure rate (which includes deeds tendered in lieu of foreclosure) has continued to trend down over the last 10 years and stands at 0.57% by unit count, and 0.28% by equity. Moreover, the annual foreclosure rate is typically under 0.1% in any given year according to Cohn Reznick. The average year of foreclosure was in year 11 when most, if not all, credits have already been received by investors.





National average economic occupancy stood at 96.7% in 2020 and there has been no material change to that number in the past 8 years. However, the percentage of properties with economic occupancy below 90% did increase from 9.5% in 2018 to 12.6% in 2020 reflecting some limited impact from the pandemic



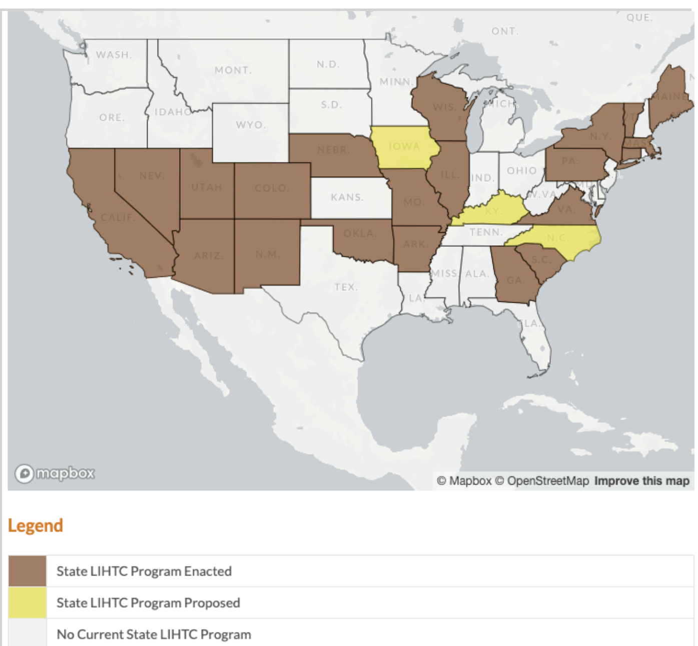


The latest median debt service coverage was 1.52, a figure which has continued to improve over the last 10 years. The percentage of properties operating below break-even has steadily declined as well. Properties with debt service coverage below 1.0 accounted for 11.8% of the survey in 2020 vs. 32.2% before 2008. If that seems too good to be true, it is partially. A significant part of that improvement is due to syndicator overrides of the Affordable Housing Investors Council's (AHIC) rating guidelines, but the overall rate without overrides is still significantly lower (25%) and the rationale behind the overrides is generally sound as discussed in the report.

www.cohnreznick.com/insights/affordable-housing-tax-credit-study-report-2021

State LIHTC

Due to growing interest from investors in state LIHTC, we've included a summary reference of state LIHTC programs below. Pennsylvania & South Carolina, for example, enacted state LIHTC programs in 2020. 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, MA, MO, NM, NY, OK, UT, and VT. There are state credit programs being proposed in IA, KY, and NC with many others such as KS, OH & TX in the pipeline.



Novogradac & Company LLP is an excellent resource for affordable housing related questions and with their permission, we have reproduced their national map of state LIHTC programs here. States shown in brown have existing state LIHTC programs. States shown in yellow have proposed state LIHTC programs.

For more info go to: https://www.novoco.com/resource-centers/affordable-housing-tax-credits/application-allocation/state-lihtc-program-descriptions

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 2021, secondary transaction activity was relatively limited and there were no traditional secondary sales of significant size to impact the primary market. Overall, we are aware of about $300 million in LIHTC secondary activity that sold bank to bank during the year versus over $1 billion in secondary activity in some years before the pandemic.

CRA Reform

CRA reform has been a focus of this newsletter for the past year or more, but for now it is essentially a non-issue as it relates to our pricing outlook. The Office of the Comptroller of the Currency (OCC) announced recently that they will not be implementing the CRA rule changes announced during the Trump Administration.

Under the Biden Administration we expect the OCC, FRB and FDIC to resume their historic collaboration as they continue to consider potential changes to CRA reform which are necessary to address the very real changes in the banking industry since CRA was first enacted in the 1970s. We would anticipate some version of modernization of the CRA to be proposed at some point during the Biden Administration.

In other CRA news, according to Novogradac and Company, the OCC, the FRB and the FDIC published a statement that extends for 36 months the period for favorable CRA regulation consideration for bank activities that help revitalize or stabilize disaster areas in Puerto Rico and the U.S. Virgin Islands hit by Hurricane Maria. The extension now lasts through Sept. 20, 2023, and applies to institutions located outside of the areas. This allows investors to take advantage of above average market returns that are available on transactions in these geographies while also potentially receiving special CRA consideration.

Preservation / Workforce Housing

At the outset of the pandemic, pricing and underwriting trends for preservation funds followed a similar trajectory to LIHTC funds, but more recently preservation fund yields have held steady given robust competition for properties. Also, while there was a similar flight to quality transactions and somewhat decreased investor demand in 2020, yields stabilized in 2021.

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.

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.

Across these sponsors, multi-investor fund sizes range from \$50mm to \$1.5B with \$100-200 mm being more typical. Preferred returns have generally been in the 7%-8% range on a pre-tax basis with total returns in the 10%–14% range. We are assuming yields will hold steady in 2022.

Occupancy and rent collection trends have been similar as well. Rent collections for preservation portfolios were also down somewhat, about 5%-10%, but again, less than feared at the outbreak of the pandemic. Similar to LIHTC properties, the relatively modest loss in rent collections is due to support from the Payroll Protection Program, enhanced unemployment benefits, and the fact that a large percentage of tenants are classified as "essential" workers.

Strategic Tax Credit Investments, An Institutional Division of Compass Securities 617-340-7040 (Direct) 800-253-8917 (Main) 50 Braintree Hill Office Park, Suite 105 Braintree, MA 02184

Wrap Up

The affordable housing market remains stable and resilient as the pandemic wears on. Few if any of us expected that it would still be the backdrop to everything we discuss when it first made headlines in early 2020. Hopefully, the latest wave peaks within the coming weeks and then recedes into the background as it did last year with the coming of spring.

Look for our updated summary of fund offerings at the end of Q1 to capture any pricing changes before our next newsletter in early July, 2022. 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. In the meantime, be well and stay healthy.

You can reach Dave Robbins at 617-340-7040

& Brian Rajotte at 503-575-9232.

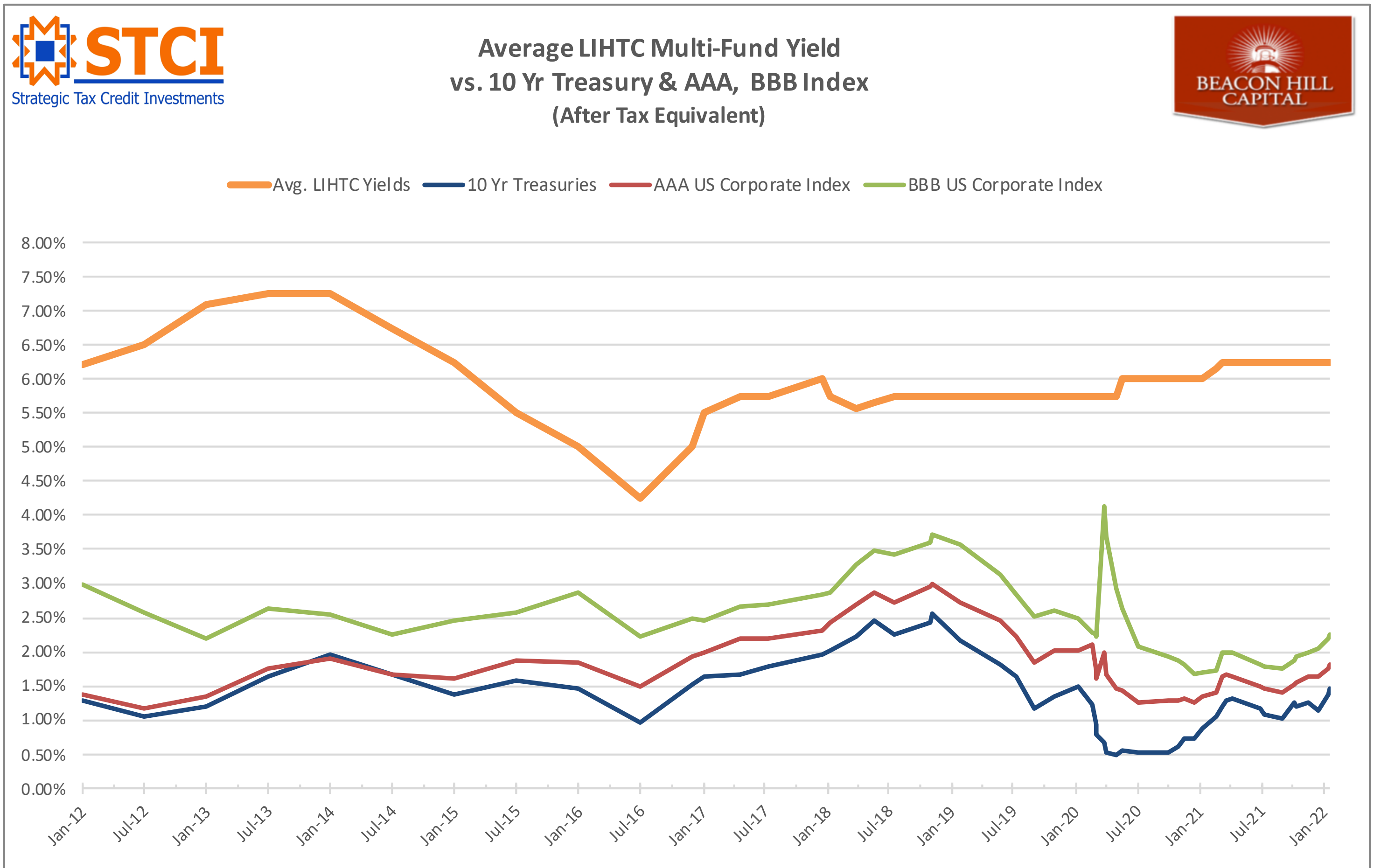
StrategicTaxCreditInvestments.com

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

Beacon Hill Capital at 781-740-8981.

bhcapital.com

LIHTC Yields vs. Alternatives



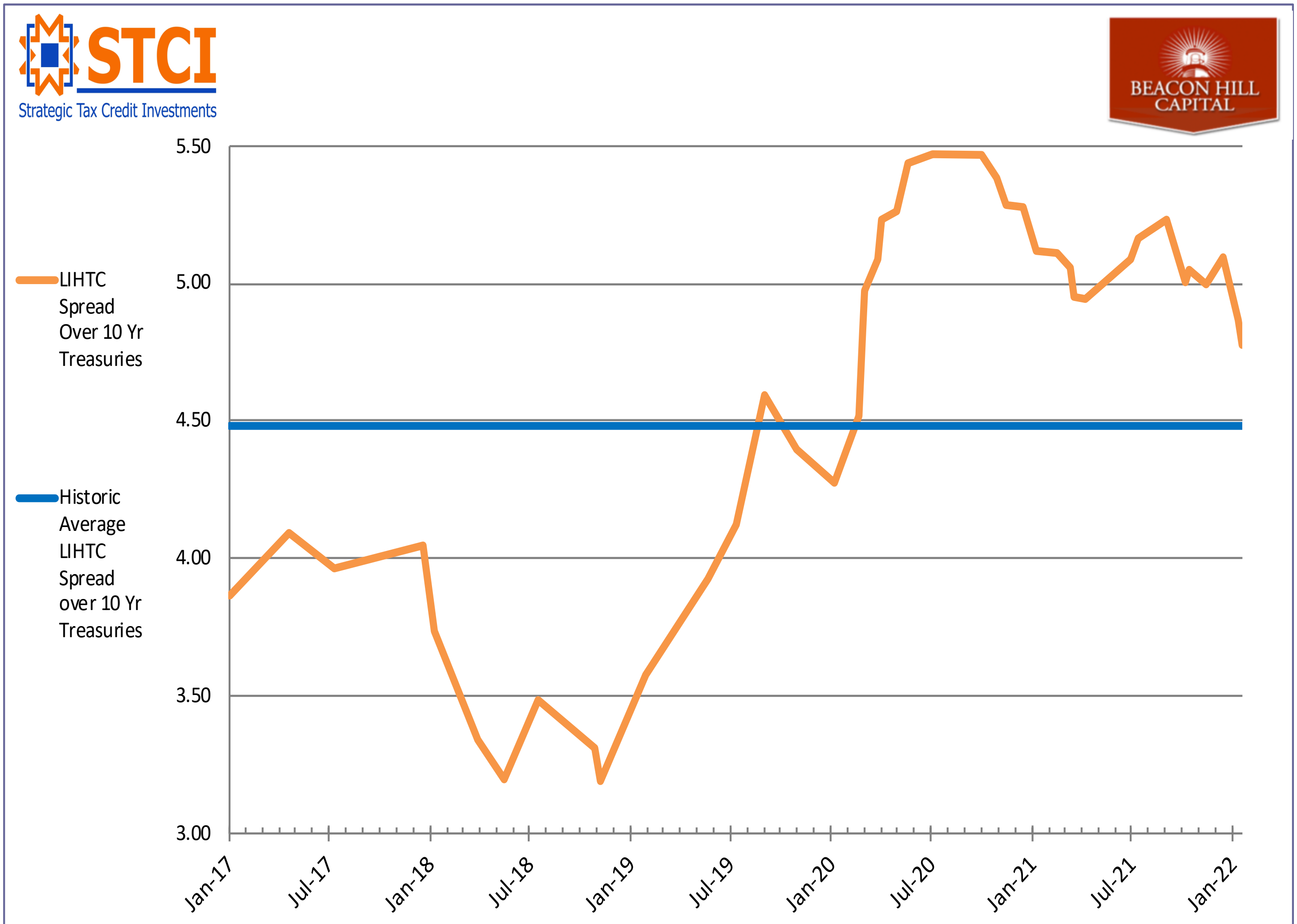
Notes: 35% Tax Rate for pre 2017, 25% for 2017, 21% for 2018-present

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

10 yr treasury: Yields adjusted to represent an after tax yield assuming a 21% corporate tax rate. **Source**: treasury.gov

AAA & BBB Yields: Yields adjusted to represent an after tax yield assuming a 21% corporate tax rate: **Source:** https://fred.stlouisfed.org/series/

LIHTC Historical Spread Over 10-Year Treasuries



Notes:
35% Tax Rate assumed for pre 2017, 25% assumed for 2017, 21% assumed 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.
10 yr treasury: Yields adjusted to represent an after tax yield assuming a 21% corporate tax rate. **Source**: treasury.gov

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LIHTC Fund Market Overview
Q1 2022

BEACON HILL CAPITAL

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%	Gut Rehab & New Construction / Rehab	Loss Ratio	Notes
Alliant	111	March 31st	200	Available	6.75%	6.50%	6.25%	6.00%	5.25%	4.00%		33%	48%52%	88%/12%	100%	November launch, March 31st closing, 18 properties in 13 states, 28% of properties closed, 100% of properties under LOI, 77% new construction
					$0.934	$0.941	$0.948	$0.956	$0.983	$1.030						
					>=$35M	>25<$35M	>15<$25M	<$15M	CRA	CRA						
CREA	88	Dec/Jan	354	Closed	7.00%	6.75%	6.60%	5.85%	5.50%	3.75%		30%	51%/49%	65% / 35%	78%	100% specified, 100% closed or under LOI. 33 properties in 18 states. 97% repeat developer, 31% senior or special needs tenancy, 47% rental assistance.
					$0.95	$0.96	$0.97	$0.99	$1.00	$1.06						
					>=$45M	>=$35M	>=$25M	< $15M	CRA I	CRA V						
Enterprise	37	Nov	221	Closed	6.60%	6.30%	6.00%	5.00%	3.75%			28%	36% / 64%	66% / 34%	N/A	19 properties in 14 states. 90% repeat developer; 28% senior tenancy; 13% subsidy by equity.
					$0.925	$0.940	$0.955	N/A	N/A							
					> $30M	> $25M	< $25M	CRA	CRA							
PNC	81	Dec/Jan	207	Closed	6.60%	6.50%	6.00%	5.75%	4.50%			33%	54% / 46%	55% / 45%	91%	Accelerated ramp up of credits due to secondary product, 10% Co-investment by PNC Bank, 77% repeat developer. 46% located in >90% minority census tracts, 50% include social services
					$0.936	$0.944	$0.959	$0.97	$1.014							
					>=$35M	>20<30M	<$20M	<$20M	CRA							
RBC	33	April	200+	Available	6.75%	6.50%	6.25%	6.00%	4.75%	4.25%	3.50%	33%	31% / 69%	80% / 20%	73%	18 properties, 15 states. 73% repeat developer, 30% senior tenancy. CRA fund tiers account for 47% of equity with tiers ranging from 3.50% to 4.75%.
					$0.960	$0.960	$0.960	$0.960	N/A	N/A	N/A					
					>=$35M	> $25M	> $10M	<$10M	CRA	CRA	CRA					
Red Stone	90	Dec	177	Closed	6.90%	6.65%	6.75%	6.50%	6.00%	5.40%		28%	47% / 53%	65% / 35%	108%	Bridged and cash needs classes for investments above $25M and $35M. 17 properties in 13 states. 98% of equity closed or under LOI. Rental subsidy on 48% of units. 41% senior properties. 65% repeat developer.
					$0.939	$0.932	$0.944	$0.937	$0.968	$0.988						
					>=$35M	>=$35M	>=$25M	>=$25M	$10-25M	<$10M						
Richman	140	March 31st	235	Available	6.75%	6.50%	6.00%	5.25%	5.00%			37%	23% / 77%	32% / 68%	108%	80% Repeat Developer, 75%+ of units benefit from rental assistance contract for entire compliance period. Hard debt not covered by Section 8 or other rental assistance contract represents only 7% of capital stack, strong credit ramp up.
					$0.950	$0.952	$0.970	N/A	N/A							
					>=$35M	>20<$35M	<$20M	CRA	CRA							
Stratford	37	Dec/Jan	170+	Available	6.50%	6.00%	5.00%	4.50%				30-35%	TBD	TBD	est 80%	15 deals in 9 states. 100% closed or under LOI.
					$0.957	$0.924	TBD	TBD								
					bridge	cash	CRA	CRA								
WNC	52	March	179	Circled	6.90%	6.50%	6.75%	6.25%	TBD			31%	52% / 48%	52%/ 48%	76%	6.50% IRR at $30M is cash needs. Ltd availability. Hard debt 31% on equity weighted basis. CA state credits available. 22 properties in 14 states. 100% identified, 85% under contract. 69% repeat developer.
					$0.950	$0.924	$0.940	$0.930	TBD							
					>$35M	>$30M*	>$25M	<$25M	CRA							

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

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LIHTC Fund Market Overview

Q1 2022

BEACON HILL CAPITAL

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	84	April	129	Closed	6.40%	6.25%	5.50%	5.00%	4.50%	21%	6.00% IRR for non-CRA investments of $20M or more not shown. 8 properties. 80% of equity is >50% senior tenancy or subsidized, 91% repeat developer. 100% 9% transactions.
					$0.955	$0.960	$0.980	$1.000	$1.020		
					> $40M	> $25M	<25M	CRA 1	CRA 2		
Enterprise	CAG 8	May	124	Closed	est 6.6%	TBD	TBD	4.25%		12%	82% of properties closed/secured, 67% new construction, 64% repeat developer, 37% of equity with rental subsidy, 32% senior.
					TBD	TBD	TBD	TBD			
					>=$25M	< $25M	CRA	CRA			
RBC	CA 7	Sep	100	Closed	6.00%	5.50%	5.00%	4.00%		26%	100% specified. 6 properties; 100% repeat developer. 42% new construction, 58% rehab, 80% family, 20% senior.
					$0.996	$1.014	$1.053				
					>=$40M	Base	LA CRA	SF CRA			
Red Stone	CA-2021	Dec	127.5	Closed	6.35%	6.00%	5.60%	5.20%		35%	6 properties. 99% of lower tier equity closed or under LOI. Rental subsidy on 62% of units. 17% senior properties. 83% repeat developer. 67% new construction. 100% tax exempt bond transactions.
					$0.958	$0.969	$0.983	$0.997			
					>=$25M	>=$20 <$25	>=$15 <$20	<$15M			
WNC	CA 19	July	83	Closed	6.25%	6.00%		TBD		40%	6 properties located in LA, San Diego, Fresno and Sacramento metro areas.
					$0.945	$0.950		TBD			
					>=$20M	< $20M		CRA			

This information does not consititute an offering. All information subject to change.
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LIHTC Disclosure

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Past performance does not guarantee future results. Not FDIC Insured. No Bank Guarantee. May Lose Value.

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BEACON HILL CAPITAL

Preservation & Workforce Housing Funds
Q1 2022

Sponsor	Fund	Close	Commitment Period/Hold (in Yrs)	Asset Mgmt Fees	Approx. Size (millions)	Pre-Tax IRR %		Co Investment	Minimum Investment Size	Approx. Available $MM	Notes
						Pref Return	Net/Residual				
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. $1B. $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	4	2021	3 / 10	1.5%	208	7.00%	9-11%	2.5% <= $2.5M	$500k	50+	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	2022	3/5	2%	100	7.00%	11.00%	up to 24.99%	$5M	150.00	Q2 2022 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	2021	2 / 7	1.5%	100	8.00%	10-12%	3% upto $3M	$1M	100.00	PWI Compliant. Target Fund level leverage of 65% to 75%. 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.