Strategic Tax Credit Investments

BEACON HILL CAPITAL

Affordable Housing Equity Market Update

January 19, 2023

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 July 2022 newsletter. 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.

Outlook

Despite the historic increase in the Federal Funds rate over the last year, tax credit pricing and investor yields have remained relatively steady with only incremental changes in the past six months. As we mentioned in July, this stability seems to be the result of the balancing of some opposing factors:

- Reduced supply: 12.5% fewer nine-percent credits as the four-year boost that began in 2018 expired at the end of 2021 and has not been renewed.
- Substantially reduced transaction feasibility due to rising interest rates and higher borrowing costs which has constrained the supply of viable transactions.
- Steady demand: Despite the rise in interest rates and the decreasing spread between LIHTC yields and benchmark bond yields, LIHTC equity investments have remained attractive for most investors relative to alternatives. Furthermore, $700M in increased demand from the GSEs in 2022 at least partially offset reduced demand from some investors. For the first half of 2023, we are anticipating somewhat increased investor demand from economic investors as well as continued steady demand from the GSEs and banks.
- Lastly, higher interest rates have all but eliminated the benefits of bridge financing at the fund level, which in turn has put some downward pressure on equity pricing, and syndicator loads, to maintain investor yields.

Looking ahead to the first half of 2023, we expect LIHTC yields to remain relatively stable as the tension between these forces remain in place, while benchmark bond yields have receded from their Q4 highs. A survey of our syndicator partners indicates that pricing at the property-level has remained relatively flat.

As LIHTC spreads to benchmark yields narrowed in 2022, investors became more focused more on portfolio quality, specification, and certainty of execution. During Q4 of 2022, as is often the case at the end of the year, competition increased among multi-investor funds for remaining equity allocations. In addition to consideration of the usual fund metrics such as pricing, yield, leverage, asset quality and sponsorship; a key differentiator was certainty of execution at the property level. Funds with competitive metrics coupled with a higher percentage of transactions secured or closed saw greater demand. This dynamic combined with a pause or slowdown in equity commitments by several large economic investors resulted in several multi-investors funds reducing their target fund size or delaying their closings into 2023.

As noted in previous letters, the pandemic contributed to significant delays in property-level transaction closing timelines. As a result, LIHTC projects that are shovel ready and with sponsors that have demonstrated a strong track record of delivering on time. This marginal difference of a penny or two is notable in that project preparedness has generally not been a significant consideration when determining LIHTC equity pricing in the past.

Inflation Reduction Act (IRA) of '22 & 15% Corporate Minimum Tax

In July, we highlighted both the proposed Global Minimum Tax (GMT) and CRA reform for their potential to impact investor demand when implemented. Nothing has materially changed on either front in the past six months. In August, President Biden signed into law the Inflation Reduction Act of 2022 (IRA) which created the 15% corporate minimum tax on book income for large companies. These topics remain on our radar for their potential future impact on investor demand, and we provide an update on the IRA below.

While many industry advocates were optimistic about legislative enhancements to LIHTC in 2022, Congress ultimately passed a Consolidated Appropriations Act of 2023 that did not include many provisions to enhance LIHTC production. Many were anticipating, or at least hoping for, a renewal of the of the 9% credit boost as well as a reduction of the '50% test' to a 25% threshold, the latter of which would result in greater feasibility for many tax-exempt bond transactions. With the November mid-term elections behind us and divided government in front of us for the next two years, the prospect for changes or improvement to the LIHTC program has decreased.

According to Novogradac, with a divided government, there will likely be an increased focus on regulatory guidance. "From the executive branch, 2023 will see guidance from the Treasury Department on provisions in the IRA as well as the GMT. Outside the administration in 2023, we are anticipating bank regulators to address CRA regulations and the Emerging Issues Tax Force (EITF) of the Financial Accounting Standards Board (FASB) to consider updated GAAP principals for tax credit investments."

Signed into law in August 2022, the Inflation Reduction Act establishes a 15% minimum corporate tax rate for large companies on "book" income (those that average more than $1 billion in adjusted financial statement income, before taxes, over three taxable years). For most companies, the Act protects certain tax incentives and allows general business credits, including LIHTC, to be taken against the minimum tax. In addition, adjustments such as accelerated depreciation and amortization are allowed.

Despite these positive aspects of the law, additional guidance from the Treasury Department is needed to address certain technical questions and provide clarification. Without this guidance, the economic benefits of tax advantaged investments such as LIHTC could be called into question and potentially impact investor demand. While one large economic LIHTC investor has curtailed their investment activity pending this guidance, it has not materially impacted overall demand to date.

According to the Baker Institute for Public Policy, "the 15% minimum tax in the IRA does not align the U.S. corporate income tax mechanism with the Organization for Economic Cooperation and Development's (OECD) Global Minimum Tax, although both use a 15% rate and apply to book income. For instance, the income threshold for in-scope companies under the OECD agreement is much lower threshold than the U.S. minimum tax. In addition, the OECD agreement aims to stop corporate profit shifting to low-tax jurisdictions through global harmonization, with U.S. companies likely paying more taxes in foreign jurisdictions as an end result. However, the objective of U.S. Inflation Reduction Act is to increase domestic corporate tax revenue. Finally, details — such as loss carryforward, depreciation deduction, and treatment of certain credits — are inconsistent across the two systems."[1]

[1] https://www.bakerinstitute.org/research/inflation-reduction-act-2022-corporate-minimum-tax-faces-major-issues

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.

In May of 2022, 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) to modernize the Community Reinvestment Act (CRA). Public comment was due by August 5th and we are hearing from industry sources that the agencies would like to finalize the new regulations by the end of Q1 2023. Even if that slips, the new regulations should be out before our next scheduled newsletter in July. Any significant changes to CRA regulation could impact the affordable housing industry as equity investment by banks comprise approximately 80% of the market.

Please see some background info on CRA reform below in *italics, please note some commentary is for contextual purposes and may not be current:*

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*
- *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 this change will discourage banks from staffing up to make equity investments and may simply make loans instead.

Another concern is that the new rules provide no 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 decline 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 provided comments to the agencies in August 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 the new rules will be phased in, and banks will complete their current CRA cycles under the existing rules. As a result, we expect any impact will be felt over several years as banks digest the new rules and potentially alter their behavior for future examination cycles.

In other CRA news, 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 September 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.

Average Income Test (aka Income Averaging)

Investors have shown limited appetite for transactions using the Average Income Test (AIT) since 2020 when Proposed regulations by the IRS suggested a "cliff event" risk. Since that time, industry working groups have been asking the IRS to respond to their concerns and provide clarifying guidance. This guidance was finally published October 12, 2022 by the IRS in the Federal Register.

The final regulations limit the impact of one unit's noncompliance on the project's ability to satisfy the average income test. It allows for the average income test to be satisfied if at least 40% of the building's units collectively average 60% or less of AMI (Area Median Income). The IRS states "It is no longer necessary to consider all low-income units in a project for residential rental property when determining whether the average income test is met."

While this is welcome news, several law firms have focused on language in the final regulations that implies yet another compliance risk scenario and they have since submitted proposed language to the IRS to address the issue. For its part, the IRS states that no "cliff test" was intended and that the hypothetical scenario put forth by the industry was not considered. At a minimum, the issue in the new language can be solved by a waiver and would have 180 days from identifying the issue to reclassify the unit designation.

Below is a summary of the origins of the AIT issue in *italics, please note some commentary is for contextual purposes and may not be current:*:

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 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.

Economic Outlook

Last year we highlighted several global economic headwinds: rapidly rising interest rates, increasing inflation concerns, the potential for recession, ongoing supply chain disruption, war in Ukraine, and China's Covid policy. All of these have contributed to unusual volatility in the capital markets and beyond.

Global inflation concerns, in the aftermath of unprecedented fiscal stimulus around the pandemic, continue to drive monetary policy and central banks continue to raise rates in response. Along with it, the consensus seems to be some level of recession is more likely than not in 2023 as rising interest rates reduce economic growth globally. China's recent flip to remove pandemic restrictions has introduced additional uncertainty to the global economic outlook. And of course, the war in Ukraine continues to disrupt food and energy markets and geopolitical stability in general.

Inflation remains at the center of business news. Year-over-year, the U.S. inflation rate is still high at 6.5% through December. Groceries, gasoline, electricity, and natural gas were all up between 10 and 15%. Combined with rising rental rates, all these increased costs hit low- and moderate-income households particularly hard.

Still, within this gloomy data, there are positive signs that inflation is starting to abate and that we are likely nearing the end of additional rate hikes in the first half of 2023. In December 2022, U.S. consumer prices fell for the first time in more than 2 ½ years indicating that inflation is slowly being brought under control. While the costs of services were up nearly 7% over the past year, the costs of goods were up less than 4% suggesting that supply chain challenges are easing too. Between July and December, the national annualized rate of inflation was only about 2.5%, indicating that inflation may have peaked in June of 2022.

With respect to interest rates, it is hard to believe that less than a year ago the Federal Funds rate was at 0.0 – 0.25% and now stands at 4.25% - 4.50% (a 15 year high, and the fastest pace of rate hikes since 1980). The current consensus seems to be that rates will top out close to 5.00% in 2023 with another 25-50 basis point increase expected at the next meeting of the Federal Open Market Committee (FOMC) on February 1. The Federal Funds rate is approaching "positive" territory, meaning that the rate will exceed the Personal Consumption Expenditure Core Price Index and become restrictive to the economy.[2]

As labor costs account for about two-thirds of the Consumer Price Index, Fed officials will want to see more evidence of reduced pricing pressures before pausing rate hikes. The labor market remains extremely tight with the unemployment rate at a 50-year low of 3.5%. The economy created 223,000 jobs in December, more than double the 100,000 number the Fed is looking for that would signal inflation is cooling.[3]

[2] *Bob Brinker's Marketimer*, Volume 38, No. 1, January 2023

[3] https://www.reuters.com/markets/us/us-consumer-prices-fall-december-weekly-jobless-claims-edge-down-2023-01-12/

LIHTC Pricing Outlook

In 2022, we flagged several developments that could upset the current market equilibrium and result in substantial changes to investor yields. As stated up front, none of those appear likely to happen now and we are instead anticipating the market will likely remain stable in the near-term. Current assumptions are that the 15% corporate minimum tax will be resolved favorably with respect to accounting treatment of housing credits and other equity investments, and any potential impact on demand from CRA reform is likely to take place over several years rather than immediately. The positive resolution of the Average Income Test guidance from the IRS does help to improve transaction feasibility where elected.

Please see below for background info on LIHTC Pricing in *italics, please note some commentary is for contextual purposes and may not be current:*

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 $0.92-$0.98 per credit range on a fully loaded basis with after-tax QIRRs in the 6.25-7.40% range with some exceptions both above and below. The range reflects a reduction in price per credit of approximately $.01-.02 and an improvement in the yield of 40 to 50 basis points since our last newsletter in July. With supply constrained due to the recent expiration of additional 9% credits and federal disaster area allocations, as well the rise in interest rates which has severely challenged project feasibility, we are assuming that pricing will generally stay in this range for the first half of the year.

This outlook is also supported by a survey of our syndicator partners with respect to lower-tier (property level) pricing, where they generally report pricing holding steady for transactions that will populate funds in the first half of 2023. Interestingly, some report a gradual downward trend where others report a gradual upward trend, likely reflecting their particular investor base as well as their fund types and timing. There is also consensus that pricing has firmed up since Q4. Moreover, it is worth noting again that the rapid rise in interest rates has dramatically reduced or eliminated the benefits of fund-level bridge financing to improve investor returns. These factors, combined with the recent retreat of the 10-year Treasury and BBB bond yields, support our pricing outlook. For more detailed metrics on current offerings, please see the LIHTC Fund Summary Exhibit A on page 19.

Given the rise in interest rates, several large CRA investors raised yield requirements in Q4. 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, investment size and the syndicator's investor base.

See the following info on LIHTC pricing in *italics, please note some commentary is for contextual purposes and may not be current:*

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.

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. When the interest rate environment permits, 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 ,when positive arbitrage exists, 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 recent years, California regional fund yields continued to rise due to the increased supply of both federal disaster and state credits. As a result, California fund yields nearly achieved par with National funds. We are seeing this trend begin to turn as the additional credit supply has been absorbed. In Q4 of last year, California regional fund yields peaked in the high 6s with a loaded price per credit in the mid-90s, or about 50 bps lower and 2-3 cents higher than national funds. We expect that CA regional funds will maintain a similar pricing differential in the first half of 2023.

Roughly eight to ten California Regional LIHTC Funds are now marketed by syndicators on an annual basis and this may increase with one large syndicator a potential new entrant in 2023. Given the relative size and elasticity of demand, the timing and regularity of the CA funds are more variable from year to year compared to multi-investor national funds.

As syndicators look to launch new funds in 2023, several report increased competition for transactions and a smaller number of deals in the pipeline compared to prior years. 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 seeing pricing stabilize in the 5.25-5.50% range after spiking as high as 5.75% early last year. In smaller metro and rural areas throughout the state, yields are expected to hold steady in the 5.75-6.00% range with some funds potentially offering even higher returns for large anchor investors.

Supply

No LIHTC program provisions made it into the year-end Consolidated Appropriations Act, 2023. The industry had been lobbying for both an extension of the 12.5% nine-percent credit boost that expired at the end of 2021 as well as a reduction of the 50% Test for bond-financed transactions but neither provision was included.

As of 2023, the size of the LIHTC equity market is estimated to be similar in size to 2022 at slightly more than $20 billion reflecting the decrease in credits associated with the expiration of the 9% credit boost and partially offset by annual per capita increases. However, this estimate does not accurately account for the reduced feasibility of many transactions, or the fact that a number of states continue to forward allocate credits to make transactions work as previously mentioned. As a result, the effective supply in 2023 remains constrained.

Please note some commentary in italics is for contextual purposes and may not be current:

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 $0.91-$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

For 2022, Fannie Mae and Freddie Mac increased their annual LIHTC equity budgets from $500M to $850M which accounted for most of the increase in investor demand last year. We expect their LIHTC equity budgets to remain flat in 2023. Towards the end of 2022, several economic investors took a pause from making additional investments following the sharp rise in interest rates. However, early indications in 2023 are that investor demand has returned as benchmark yields have receded from Q4 highs, LIHTC returns continue to be attractive relative to alternative investments, and some new and legacy investors are poised to enter the market.

Please note some commentary in italics is for contextual purposes and may not be current:

We continue to monitor the growing interest in ESG related investments. While there remains some level of uncertainty around what "qualifies" as an ESG investment, both LIHTC and Preservation funds seem to incorporate adequate characteristics. There has been a marked increase in investors asking for ESG related statistics on their investments, and a material, though not yet impactful, increase in the volume being invested to satisfy internal ESG objectives. While this segment of the investor group appears to be growing, it has not yet translated into a level of demand that has affected pricing.

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

The Federal Reserve has tried to tame an inflation rate that reached a 40-year high by raising rates at the fastest pace since 1980. One year ago, the Federal Funds rate stood at 0.0 – 0.25%. In our July newsletter, the rate stood at 1.50% – 1.75% and today it stands at 4.25% - 4.50% with the current consensus suggesting that it will top out around 5.0% in the first half of 2023.

The result has been a dramatic increase in borrowing costs, dislocation in the capital markets and significant challenges to the feasibility of transactions. 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 75-90 basis points or more and has generally fluctuated between 3.30% and 4.20% over the past several months. As we go to press, it is approximately 3.40%, up from approximately 3.00% six months ago.

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 133 basis points (bps) in 2006 to a high of around 925 bps in 2010. The historic average has been approximately 444 bps. Using a non-CRA 6.75% after-tax QIRR from the most recent round of closed multi-investor funds, today that spread is slightly below historic norms to approximately 404 bps. This spread is similar to what we reported six months ago as LIHTC yields have adjusted as well. It is worth noting that although the current spread is below the historic average, there is precedent for the market clearing at similar or narrower spreads in the past ten years.

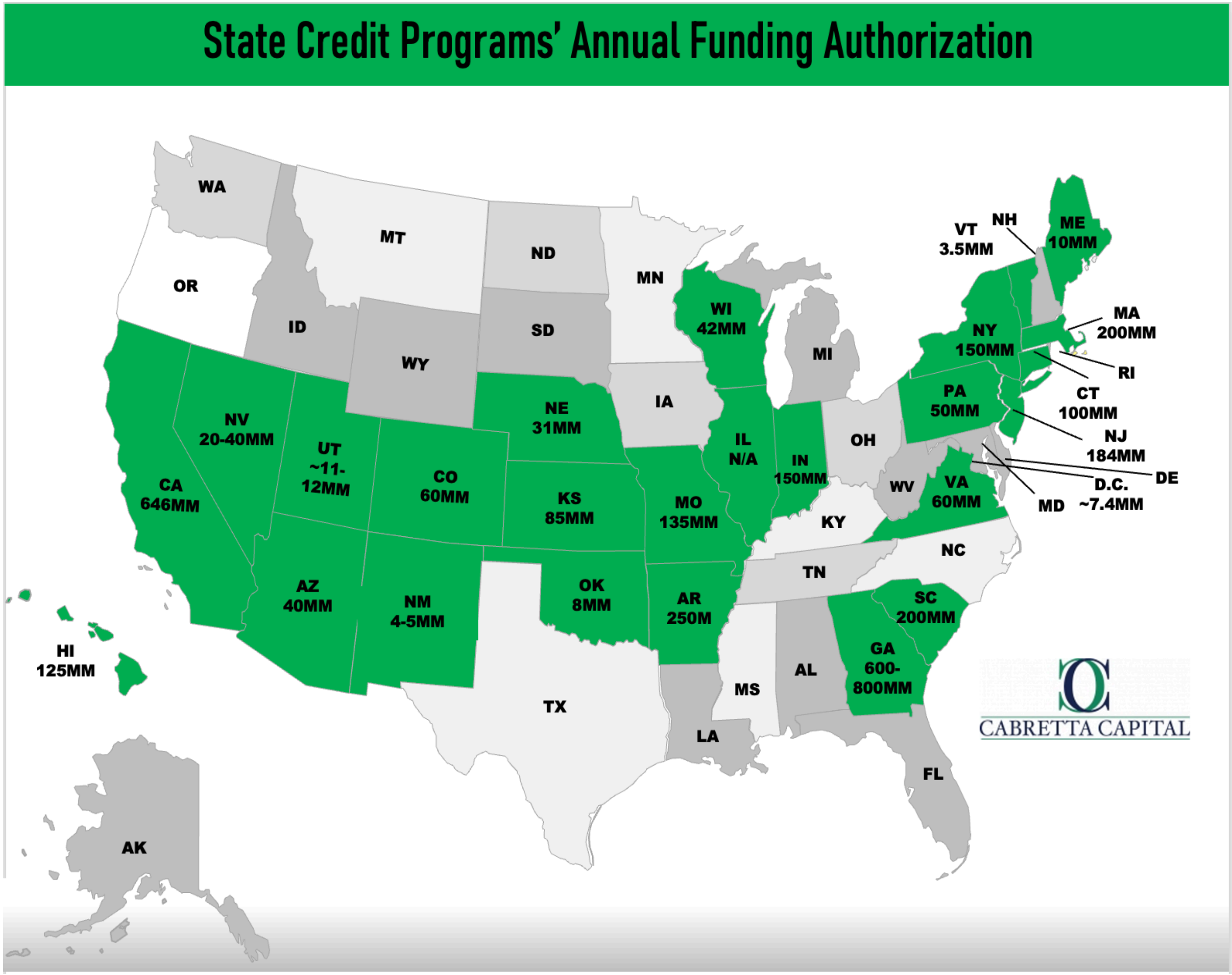
Over the years, many investors have indicated that BBB rated corporate bonds may be the best credit proxy for LIHTC investments. Historically, LIHTC yields have maintained a spread approximately 300 bps over BBB's after-tax equivalent. Currently, BBBs are roughly 5.40% with the resulting after-tax equivalent spread to LIHTC at 250 bps, or about 50 bps below the historical average.

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

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 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 (www.cabrettacapital.com) was founded in 2015 by Brent Watts who has been working in the industry for nearly 20 years.



Lou Bosso of Cabretta Capital reports:

Legislative initiatives for state affordable housing credits continue their steady march in 2023. States that currently enjoy the benefit of a state affordable housing credit have proven far more attractive to developers amid recent finance and labor headwinds. With more than half of the states now offering a state credit incentive, this resource has become a permanent and critical piece of the country's affordable production engine

Strong initiatives in large, bellwether states like Texas and Ohio and even Montana have been years in the making. The Texas proposal calls for a 10-year credit with a program cap of $250MM annually. TX is looking at a multi-billion-dollar budget surplus and given how thoroughly the issue has been socialized in Austin over the past 6 years there, this biennial session looks promising for the credit. Additionally, key committee seats have shifted which should put even more wind behind it.

CABRETTA CAPITAL

States' Per Capita Spending on LIHTC

State	Population	Annual Credit Authorization	Per Capita Credit Spend	Population Rank	Per Capita Spend Rank
Hawaii	1,474,265	$ 125,000,000.00	$ 84.79	40	1
Georgia	10,916,760	$ 700,000,000.00	$ 64.12	8	2
South Carolina	5,217,037	$ 200,000,000.00	$ 38.34	23	3
Kansas	2,954,832	$ 85,000,000.00	$ 28.77	35	4
Massachusetts	7,126,375	$ 200,000,000.00	$ 28.06	15	5
Connecticut	3,612,314	$ 100,000,000.00	$ 27.68	29	6
Indiana	6,845,874	$ 150,000,000.00	$ 21.91	17	7
Missouri	6,188,111	$ 135,000,000.00	$ 21.82	19	8
New Jersey	9,388,414	$ 184,000,000.00	$ 19.60	11	9
California	39,995,077	$ 646,000,000.00	$ 16.15	1	10
Nebraska	1,988,536	$ 31,000,000.00	$ 15.59	37	11
D.C.	644,743	$ 7,400,000.00	$ 11.48	50	12
Colorado	5,922,618	$ 60,000,000.00	$ 10.13	21	13
Nevada	3,185,426	$ 30,000,000.00	$ 9.42	32	14
New York	20,365,879	$ 150,000,000.00	$ 7.37	4	15
Maine	1,369,159	$ 10,000,000.00	$ 7.30	42	16
Wisconsin	5,935,064	$ 42,000,000.00	$ 7.08	20	17
Virginia	8,757,467	$ 60,000,000.00	$ 6.85	12	18
Arizona	7,303,398	$ 40,000,000.00	$ 5.48	14	19
Vermont	646,545	$ 3,500,000.00	$ 5.41	49	20
Pennsylvania	13,062,764	$ 50,000,000.00	$ 3.83	5	21
Utah	3,373,162	$ 11,500,000.00	$ 3.41	30	22
New Mexico	2,129,190	$ 4,500,000.00	$ 2.11	36	23
Oklahoma	4,000,953	$ 8,000,000.00	$ 2.00	28	24
Arkansas	3,030,646	$ 250,000.00	$ 0.08	33	25

Secondary Transactions

Please note some commentary in italics is for contextual purposes and may not be current:

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 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 was dominated by a single large offering of more than $1 billion from one major bank. Such a large secondary would typically create concern around potential impact to pricing in the primary market, but we did not see an impact for several reasons. The secondary was 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 for investors that are not regular market participants. An initial closing is expected in Q1 2023. We are also aware of two smaller secondaries in the $40-60 million range purchased by one major bank.

Preservation & Workforce Housing

Please note some commentary in italics is for contextual purposes and may not be current:

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 in recent 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 steady despite increasing interest rates.

Similar to LIHTC funds, yields and terms have remained essentially the same over the past 6 months and are projected to remain in a similar range for the first half of 2023. Investor interest remains strong for multifamily, and for affordable multifamily rental housing in particular. Similar to the LIHTC market, there were some investors who paused or at least slowed the pace of their commitments during 2022 as interest rates spiked. The reduction in demand reportedly helped bring about an overdue market correction and led to more reasonable underwriting assumptions according to one major syndicator. With benchmark bond rates receding, investor demand is expected to regain momentum in 2023.

One caveat to investor demand in 2023 could be the proposed CRA rule changes which 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 housing supply and relatively low rent levels.

Across our sponsors, multi-investor fund sizes range from $100 million to $1.74 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 our attached summary of current offerings.

Wrap Up

Please look for our pricing update at the end of Q1 when we send out our updated summary of fund offerings to capture any pricing changes before our next newsletter in July, 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

Beacon Hill Capital at 781-740-8981.

bhcapital.com

Exhibit A

LIHTC Market Update: January 2023

STCI
Strategic Tax Credit Investments
An Institutional Division of Compass Securities Corp.

BEACON HILL CAPITAL

LIHTC Fund Market Overview
Q1 2023

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%	Repeat Developer	New Const / Rehab	Loss Ratio	Family / Senior	Notes
Alliant	117	June	165	Preliminary	7.15% $0.943 >=$35M	7.00% $0.9470 >=$25M	6.75% $0.954 >=$15M	6.50% $0.960 <$15M		Various TBD CRA		34%	48% / 52%	91%	63% / 37%	106%	95% / 5%	24% closed, additional 29% under LOI. 97% specified with 14 properties in 10 states. 91% Repeat developers. 32% of equity has supoortive services
CREA	96	Dec/Jan	244	Closed	7.00% $0.94 >=$30M	6.60% $0.96 >=$20M	6.10% $0.97 < $20M	5.50% $1.00 CRA I	5.00% $1.02 CRA II	4.75% $1.03 CRA III	4.00% $1.06 CRA V	31%	38% / 62%	80%	53% / 47%	84%	86% / 14%	100% specified; 85% closed and 15% under LOI. 24 properties in 17 states. 80% repeat developer, 14% senior or special needs tenancy
Enterprise	41	June	275	Available	7.25% $0.920 >=$50M	7.00% $0.940 >=$35M	6.50% $0.950 >=$20M	6.25% TBD >=$15M	6.00% TBD < $15M		Various TBD CRA	25-28%	40% / 60%	75%	45% / 55%	95%	75% / 25%	23 properties, 60% are closed or under LOI
PNC	87	June	175	Preliminary	7.00% $0.935 >=$50M	6.90% $0.940 >=$35M	6.50% $0.950 >=$20M	6.00% TBD >=$10M	Various TBD CRA			36%	35% / 65%	95%	45% / 55%	99%	75% / 25%	Accelerated credit delivery due to secondary product, high percentage of portfolio already stabilized or in construction, 10% Co-investment by PNC Bank
RBC	34	December	96	Closed	6.75% $0.960 >=$35M	6.50% $0.960 >=$25M	6.25% $0.960 >=$10M	6.00% $0.960 <$10M	5.00% CRA I	4.25% CRA III	3.75% CRA V	35%	55% / 45%	68%	100%	110%	69% / 31%	9 properties in 8 states. 82% repeat developers. 63% of equity at CRA tier pricing.
Red Stone	99	April	175-225	Available	7.10% $0.923 >=$30M	6.70% $0.936 >=$20M	6.25% $0.951 >=$10M	5.40% $0.981 < $10M	4.35% $1.023 CRA			25%	49% / 51%	66%	81% / 19%	126%	90% / 10%	19 properties in 10 states and D.C. Portfolio 95% identified, 90% LOI/closed. Rental subsidy on 40% of equity. 3.5% fund reserves; 0.25% deferred fee.
Richman	144	June	250	Preliminary	7.10% TBD >=$35M	6.75% TBD >=$25M	6.50% TBD <$25M	Various TBD CRA				<30%	70% / 30%	>60%	60% / 40%	130%	70% / 30%	Strong CRA markets. 100% specified, majority repeat developer, High percentage of units benefit from rental assistance contract for entire compliance period
Stratford	43	May	150-200	Available	7.00% $0.908 Cash Needs		5.50% N/A CRA		3.75% N/A CRA			30%	50% / 50%	TBD	50% / 50%	100%	TBD	N/A
WNC	54	March	165	Available	7.40% $0.914 >=$35M	7.15% $0.921 >=$25M	6.75% $0.936 <$25M	6.25% $0.950 CRA				30%	33% / 67%	59%	67% / 33%	105%	80% / 20%	92% under LOI. 59% Repeat Developers. 12 Properties, 11 States. Fund serves homeless, Native American/tribal, disabled and extremely low income populations

"LIHTC Disclosure
This is not a solicitation. This material is for educational purposes only and is not meant to be investment advice. This material may represent an assessment of the LIHTC market environment at a specific point in time and is not intended to be a forecast of future events, or a guarantee of future results. To determine if the LIHTC Fund(s) are an appropriate investment, carefully consider the investment objectives, risk factors, charges and expenses before making any investment. This and other information can be found in a fund's private placement offering memorandum, or other offering information specific to the investment structure, which can be obtained by calling 781-740-8981 or the specific contact information provided in the investment materials. Read all materials carefully before considering investing. Diversification may not protect against market risk. Current and future portfolio holdings are subject to risks as well. LIHTC private placements involve risk including failure to achieve desired tax benefits and the possible loss of principal. Past performance does not guarantee future results. Not FDIC Insured. No Bank Guarantee. May Lose Value."

Loss Ratio: Tax losses before dispoition as a percentage of capital invested
This information does not constitute an offering. All information subject to change.
STCI and Beacon Hill Capital are institutional divisions of Compass Securities Corporation. Securities offered through Compass Securities Corp, member FINRA SIPC; www.CompassSecurities.com

STCI Strategic Tax Credit Investments

LIHTC Fund Market Overview

Q1 2023

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	90	Jun-22	143.2	Closed	6.65%	6.50%	6.25%	5.75%	5.00%	34%	100% specified; 82% closed and 18% under LOI. 7 properties all in CA. 82% repeat developer, 18% senior
					$0.960	$0.970	$0.980	$0.990	$1.010		
					>=$35M	>=$30M	>=20M	CRA 1	CRA 2		
Enterprise	CAG 8	July	113	Closed	6.35%	6.00%	5.25%	5.00%	4.75%	7%	9 properties. 78% repeat developer. 83% senior tenancy. 66% of units covered by rental subsidy.
					$0.940	TBD	TBD	TBD	TBD		
					>=$35M	<=$10M	LA CRA	StocktonCRA	SF/SB CRA		
PNC	90	May	100	Preliminary		5.50%	5.25%	5.00%		< 40%	Includes immediate credits due to properties already closed / crediting. Co-investment by PNC Bnak
						TBD	TBD	TBD			
						CA	SD, Fres	LA			
RBC	CA 8	February	101	Available	6.00%	5.50%	4.50%			32%	San Francisco, Ventura, Los Angeles, Imperial, and Kern Counties. 4 of 5 properties closed
					$0.990	$1.015	$1.045				
					Base	LA CRA	Bay Area				
Red Stone	CA-2022	Nov-23	137	Closed	6.80%	6.45%	5.80%	5.30%		19%	10 properties: 95% specified and closed or under contract; Rental subsidy on 31% of units. 22% senior properties. 67% repeat developer. 100% new construction, and 4% tax exempt bond transactions.
					$0.946	$0.955	$0.974	$0.989			
					>=$30M	>=$20 <$30	>=$10 <$20	<$10M			
WNC	CA 20	22/23	150	Available	6.50%	6.25%	6.00%			33%	Initial closing in August 2022. Second in Dec 2022 and final close by August 31, 2023.11+ properties located in 7 separate CA markets. 75% specified, 70% under LOI. 35% of units have rental assistance. 22% senior tenancy. PPC reflects inclusion of state and energy credits and 3% upper-tier reserves
					$1.005	$0.996	$0.870				
					>$15M	>$10M	<$10M				

This information does not consititute an offering. All information subject to change.
STCI is an institutional division of Compass Securities Corporation. Securities offered through Compass Securities Corp, member FINRA SIPC; www.CompassSecurities.com

LIHTC Disclosure

This is not a solicitation. This material is for educational purposes only and is not meant to be investment advice. This material may represent an assessment of the LIHTC market environment at a specific point in time at a specific point in time and is not intended to be a forecast of future events, or a guarantee of future results. To determine if the LIHTC Fund(s) are an appropriate investment, carefully consider the investment objectives, risk factors, charges and expenses before making any investment. This and other information can be found in a fund's private placement private placement offering memorandum, or other offering information specific to the investment structure, which can be obtained by calling 781-740-8981 or the specific contact information provided in the investment materials. Read all materials carefully before considering investing. Diversification may not protect against market risk. Current and future portfolio holdings are subject to risks as well. LIHTC private placements involve risk including failure to achieve desired tax benefits and the possible loss of principal.
Past performance does not guarantee future results. Not FDIC Insured. No Bank Guarantee. May Lose Value.

STCI
Strategic Tax Credit Investments
An institutional division of Compass Securities Corp.

BEACON HILL CAPITAL

Market Overview
Q1 2023

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	2023	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	Closed	4 / 10-12	1.5-2.0%	1740	7.00%	10-12%	2% up to $10M	$250K	0.00	Approx $940M deployed as of end Q3. 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	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	6%- 7%	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 6% annual return, 100% until return of capital, 95% until a non-compounded 10% annual return, 80% thereafter
RBC	1	2023	2 / 7	2% for 24 months, 1% thereafter	100	8.00%	10+%	TBD	$5M	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. Large component of new construction
WNC	3	2023	3 / 8	1.5%	300	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.

This information does not consititute an offering. All information subject to change.
STCI is an institutional division of Compass Securities Corporation. Securities offered through Compass Securities Corp, member FINRA SIPC; www.CompassSecurities.com

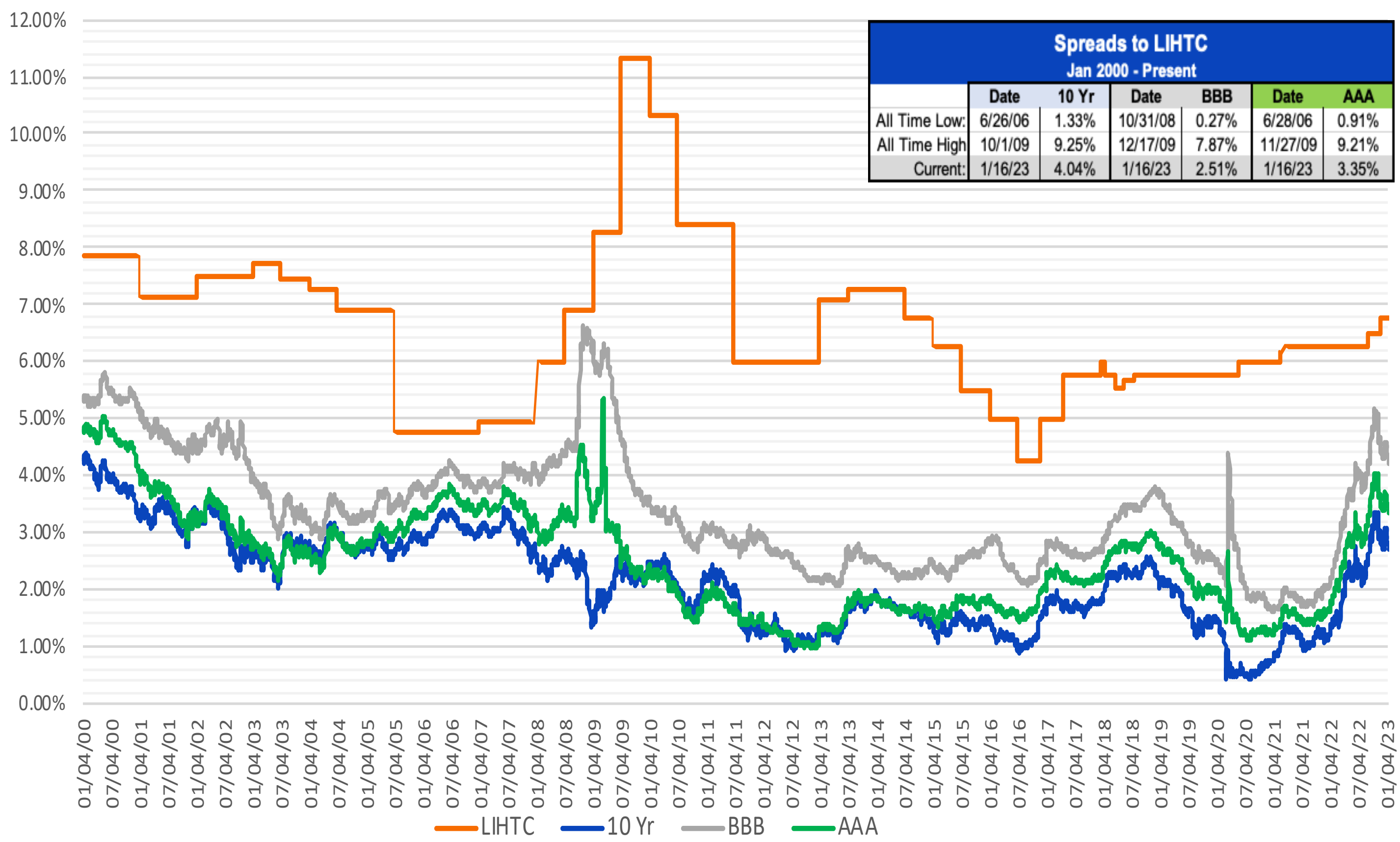
Disclosure

This is not a solicitation. This material is for educational purposes only and is not meant to be investment advice. This material may represent an assessment of the Preservation Fund market environment at a at a specific point in time and is not intended to be a forecast of future events, or a guarantee of future results. To determine if the Preservation Fund(s) are an appropriate investment, carefully consider the investment objectives, risk factors, charges and expenses before making any investment. This and other information can be found in a fund's private placement private placement offering memorandum, or other offering information specific to the investment structure, which can be obtained by calling 781-740-8981 or the specific contact information provided in the investment materials. Read all materials carefully before considering investing. Diversification may not protect against market risk. Current and future portfolio holdings are subject to risks as well. Preservation private placements involve risk including failure to achieve desired tax benefits and the possible loss of principal. Past performance does not guarantee future results. Not FDIC Insured. No Bank Guarantee. May Lose Value.

STCI
Strategic Tax Credit Investments

BEACON HILL CAPITAL

LIHTC Yields vs. Tax Adjusted Alternatives



Spreads to LIHTC
Jan 2000 - Present

	Date	10 Yr	Date	BBB	Date	AAA
All Time Low:	6/26/06	1.33%	10/31/08	0.27%	6/28/06	0.91%
All Time High	10/1/09	9.25%	12/17/09	7.87%	11/27/09	9.21%
Current:	1/16/23	4.04%	1/16/23	2.51%	1/16/23	3.35%

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/

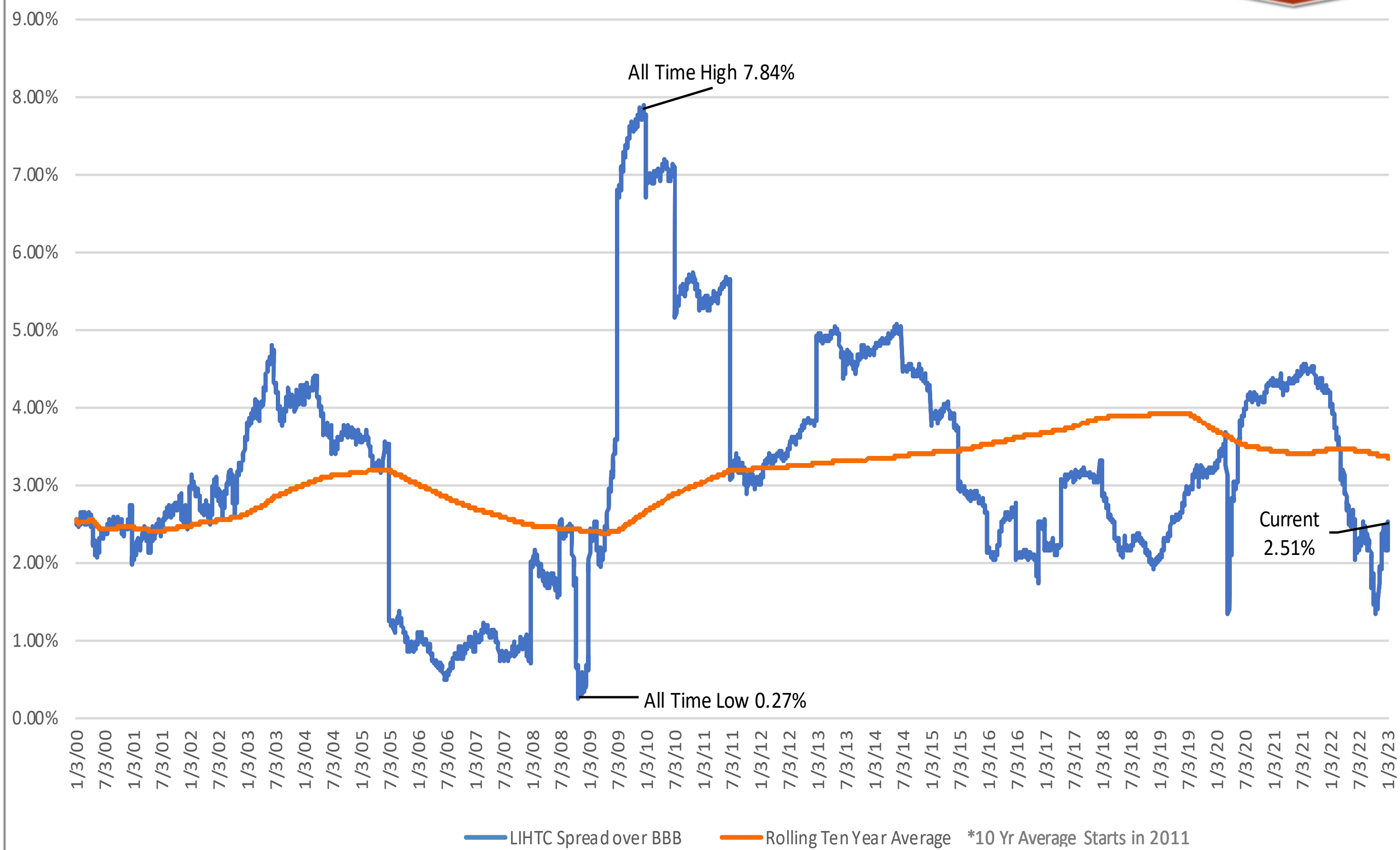
LIHTC Disclosure: This is not a solicitation. This material is for educational purposes only and is not meant to be investment advice. This material may represent an assessment of the LIHTC market environment at a specific point in time and is not intended to be a forecast of future events, or a guarantee of future results. To determine if the LIHTC Fund(s) are an appropriate investment, carefully consider the investment objectives, risk factors, charges and expenses before making any investment. This and other information can be found in a fund's private placement offering memorandum, or other offering information specific to the investment structure, which can be obtained by calling 781-740-8981 or the specific contact information provided in the investment materials. Read all materials carefully before considering investing. Diversification may not protect against market risk. Current and future portfolio holdings are subject to risks as well. LIHTC private placements involve risk including failure to achieve desired tax benefits and the possible loss of principal. Past performance does not guarantee future results. Not FDIC Insured. No Bank Guarantee. May Lose Value.

LIHTC Market Update: January 2023

STCI
Strategic Tax Credit Investments

Tax Adjusted BBB Spread to LIHTC vs. Rolling Average

BEACON HILL CAPITAL



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.

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

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