Affordable Housing Equity Market Update

July 14, 2021

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 as public welfare investments (PWIs) by targeting low- to moderate-income households, which can help attract equity from CRA investors. These types of funds fall along a spectrum depending upon how oriented they are toward PWI criteria. In terms of portfolio composition, some include a component of new construction workforce housing while others do not.

This issue follows our January 2021 newsletter which, along with previous newsletters, are available on our website: StrategicTaxCreditInvestments.com

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

Summary

Since January, yields have been relatively stable, trending upward slightly in general, and downward a bit in some of the more competitive CRA markets. We are forecasting continued stability through year-end with a roughly equal probability of yields rising or falling modestly in multi-investor funds as demand from several larger economic investors is still to be determined.

The bottom line is that there have been no major changes in the market since our January newsletter, but some of the pandemic-related issues that the housing industry has been working through will continue to be a focus for underwriting through the remainder of 2021.

That said, keep an eye on the following topics for year-end and into 2022. All will be discussed in more detail in their relevant sections of this newsletter.

- **Tax**: the potential for tax reform by year-end (likely through budget reconciliation) and potentially higher corporate tax rates.
- **Supply**: the proposed Affordable Housing Tax Credit Improvement Act (AHCIA), which is part of the Biden Administration's American Jobs Plan and expected to be included in their FYE 2022 budget, would dramatically increase supply in 2022 & 2023.
- **Demand**: likely increasing demand for LIHTC equity investment from both Fannie Mae and Freddie Mac as well as several economic investors, but unlikely to keep pace with increased supply indicating the potential for a pricing adjustment in 2022.
- **Underwriting**: Income Averaging guidance is still pending, and pandemic-related elevated construction costs, labor shortages, and supply chain issues, remain considerations.

Outlook

The affordable housing industry, and the market for LIHTC investments specifically, continues to demonstrate resiliency in times of economic distress. It weathered 2020 and the brunt of the COVID-19 global pandemic well, albeit with massive amounts of federal fiscal stimulus coupled with eviction moratoriums. It is tempting to think the pandemic is fully behind us, but it is important to note that there are still 6 million more people unemployed in the US today than in February of 2020 and the Delta variant continues to pose a risk even to areas that are further along the vaccination curve.

Affordable housing fundamentals remain strong with 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.

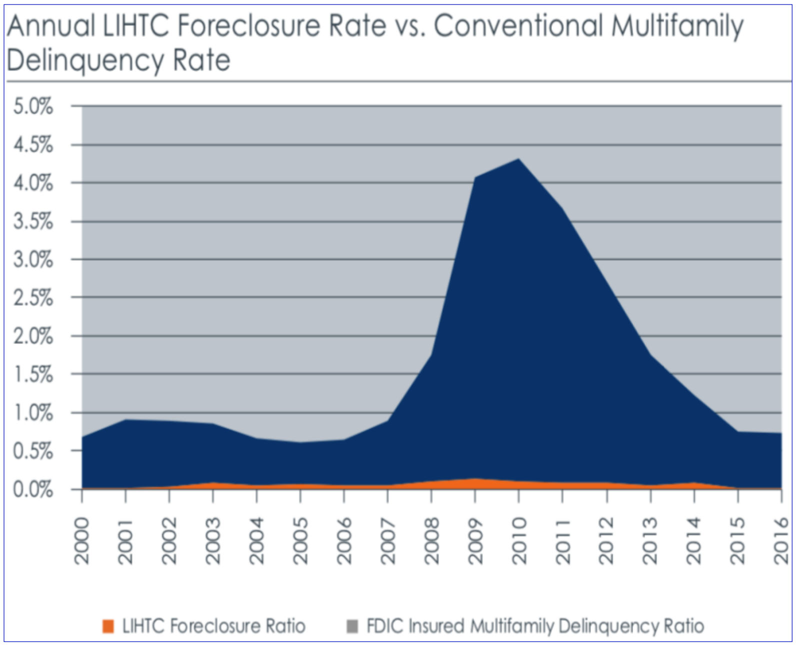
In January, we highlighted a concern with respect to state budget deficits and the potential impact to affordable housing. State and local governments often contribute to the financing of affordable housing at the project level, closing funding gaps with sources such as grants, TIF loans, real estate 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; however, many states now find they have budget surpluses. According to recent articles in the New York Times and Newsweek, 22 states are projecting budget surpluses for 2021 a number of states are proposing to use that surplus to help low-income households pay off past due rent and utility bills.

Underwriting

Syndicators continue to respond to the impact of the pandemic on the underwriting of new transactions and existing portfolios. As a result, it makes sense to recap the underwriting challenges we previously highlighted.

As a result of the pandemic, all of our syndicator partners 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. Some syndicators have added three months to all construction, lease-up and credit delivery schedules, whereas others are evaluating timelines on a transaction-by-transaction basis.

Looking ahead, 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



Housing Tax Credit Performance: High Performance and Increased Need. A CohnReznick LLP Report. Investment Services 2017: https://www.cohnreznick.com/insights/housing-tax-credit-monitor

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 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. On the one hand, new construction's longer timeline to completion might miss much of the impact of the pandemic. Whereas rehabilitations of existing properties face greater near-term construction challenges, but benefit from having qualified renters in place if the economic recovery is prolonged. 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 2020, across a range of syndicators, we consistently saw initial monthly rent collections range from 85-95% of historic averages 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 have dropped their increased focus on this as significantly reduced rent collections never materialized. 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 has been extended several times this year and is set to expire on July 31. Indications are that it will not be extended beyond that deadline. Please note eviction moratoriums may also be set at the state and local levels. With the economy continuing to post strong economic growth and many states 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 can be avoided.

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.

Building Costs & Supply Chain Disruption

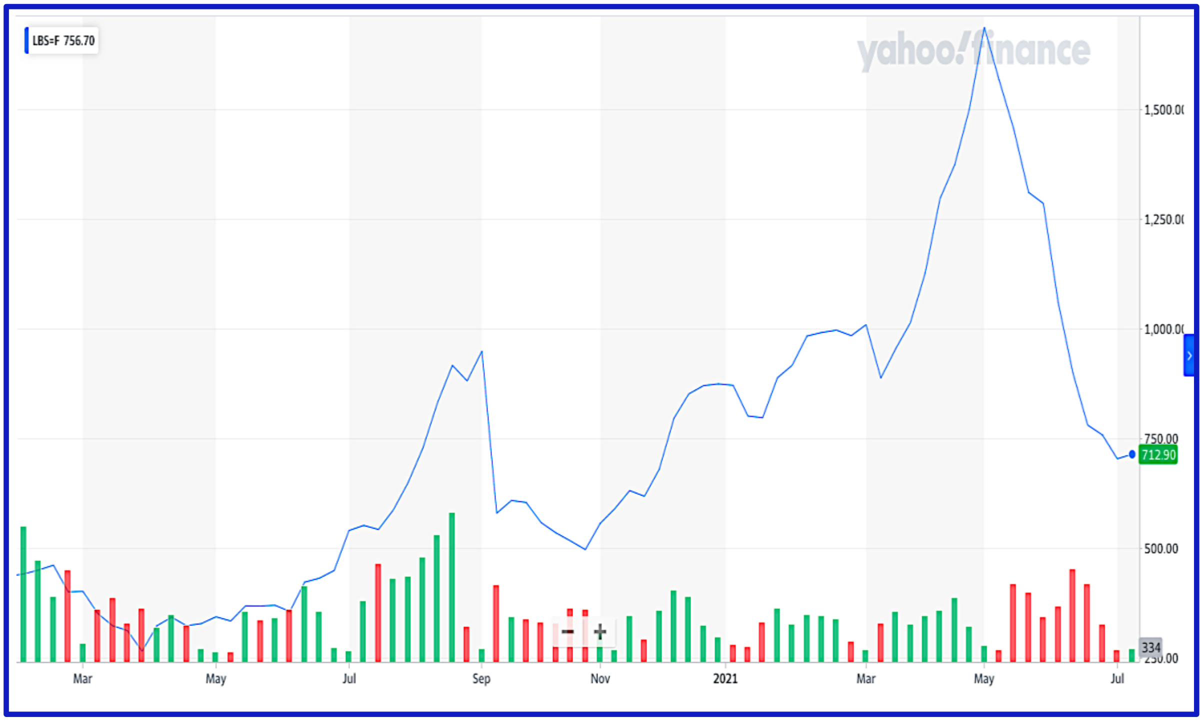
Developers have recently enjoyed increased supply of financial resources available to build LIHTC projects, however, they have encountered new challenges as the economy continues to feel the effects of the pandemic. LIHTC development has been slowed due to factors that have plagued the construction industry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

Building supply costs have increased across the board, but the most notable item over the last six months 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. Factors resulting from climate change, supply chain issues, and increased demand compounded lumber price increases until early June. Since then, prices have come down dramatically, but are still roughly double the cost compared to this time last year. Hopefully this is an indication that commodity prices will find an equilibrium as the year moves on avoiding an inflationary period, ultimately resulting in more efficient construction of housing.

Please see the chart from [Yahoo! Finance] illustrating the data. Random Length Lumber Futures (LBS=F)



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 a slight reduction in investor demand during the pandemic, LIHTC yields have been on the rise.

The 4% credit for tax-exempt bond financed properties had previously been calculated on a floating rate basis and had been well below 4% for a very long time. Recently, it has been in the low 3% range. The permanent change to a fixed 4% rate improved the feasibility of bond financed transactions and created more housing. As a result of the increased supply (about 12-13% to the total market) a pricing adjustment has worked *its way through the market and resulted in increasing investor yields.*

Federal credit pricing has remained relatively stable in the first half of 2021 with a slight downward trend in pricing and slight upward trend in yields. As investors increasingly focused on pandemic-related underwriting concerns, there has been a "flight to quality" which contributed to firming prices for the best transactions, while less desirable projects are receiving lower pricing.

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-\$0.97 per credit range on a fully loaded basis with after-tax QIRRs in the 5.75-6.50% range with some exceptions both above and below this range. This represents a slight improvement to the pricing we reported in January. Yields for the largest, non-CRA investors have moved up slightly on the latest fund offerings as syndicators compete for the relatively limited number of investors who are willing to make the largest investments in a fund. All indications are that yields will remain in a similar range for the second half of 2021. Our outlook assumes that a few large, previously dormant insurance companies will make equity commitments before year-end and that demand from Fannie Mae and Freddie Mac will not increase substantially until 2022. Our forecast is also assuming that the market will not price-in a potential change in corporate tax rate for funds closing in 2021.

For CRA-motivated investors, the yield range has generally been between 4.00% for higher demand metropolitan statistical areas and counties to 6.00% for less competitive CRA markets, or funds without CRA pricing tiers, and we expect it to continue through year-end. As usual, there are exceptions to this range, both above and below it.

For example, we are starting to hear of declining yields in higher-demand CRA markets. The most competitive CRA areas (e.g. Bay Area, NYC five boroughs, Boston, Utah, etc.) have yields that 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 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 6.50% 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.*

$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.

California Regional Funds

Due to California's large economy and population (12% of US population), it has always accounted for a relatively large percentage of the LIHTC market. California also received roughly $2.6B of the $25B of recently passed rental assistance.

Historically, syndicators have offered California regional funds for three primary reasons: the large number of California transactions, demand from the large number of banks located in the state and the historic disparity in pricing between California transactions and the national average.

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

In January 2021, yields ranged from 4.00% IRR in the Bay Area, 4.25%-4.50% in LA/San Diego and 5.00% statewide. Today, while projects in the Bay Area are still commanding premium pricing and fund level offerings remain in the 4.00%-4.50% range, yields have risen to 5.00% in Los Angeles and San Diego, and 5.50%-6.00% in smaller metro and rural areas with premium pricing for large investments ($25M+) at 6.25% and higher.

Following this adjustment, pricing in CA has stabilized. Now that the pricing differential between national and California regional funds has narrowed substantially, investors can expect to see an increasing amount of California product in national funds and potentially a decrease in the number of CA funds offered overall.

Looking Ahead to 2022

Typically, we stick to a six-month horizon for this newsletter. This coincides with the LIHTC national fund cycle from a pricing perspective and avoids gazing too deeply into our crystal ball. However, for this edition we think it is important to flag several developments that could upset the current market equilibrium and result in substantial changes to investor yields looking ahead to 2022.

The Biden Administration has submitted a $6 trillion FY 2022 budget request which incorporates the American Jobs Plan. Components of the budget proposal include raising 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 are many variables that will ultimately shape the corporate tax landscape, but all are in the direction of increasing the corporate tax base.

The American Jobs Plan includes $100 billion in new and expanded credit programs including an additional $55 billion for LIHTC and "a marked increase in the resources available through LIHTC."

There have been questions on the proposed 15 percent 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 greatly in flux, the implementation of this tax could potentially increase the pool of interested institutional investors in the market.

Tax Reform

If (and we emphasize *if*)**,** the corporate tax rate is changed as part of the 2021-2022 budget process, a 25% rate seems to be the current consensus given indications from the Biden Administration as well as Senator Joe Manchin (D – WV) who would be a crucial vote for the Democrats. While the LIHTC market is not currently pricing in a change to the corporate tax rate, and there is certainly a scenario where the tax rate doesn't change, a 25% corporate tax rate applied to recent LIHTC national funds would result in increased investor yields to the tune of 75-100 basis points. Keep in mind that the yield impact from any change in corporate tax rate would vary for every property, and therefore every fund, as the impact is dependent upon the portion of total tax benefits that are derived from tax deductions.

Supply

If some or all of the provisions of the Affordable Housing Credit Improvement Act 2021 (AHCIA) make their way into the federal budget or any infrastructure legislation before year-end, it is likely that the supply of LIHTC will increase substantially and pricing will have to reset.

The AHCIA, parts of which were enacted in 2019, was cosponsored 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%.

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.

In this section, we highlight the major provisions in the AHCIA that will have the greatest impact on LIHTC supply. For a more comprehensive analysis of the AHCIA and the provisions streamlining and enhancing the LIHTC program, please see this excellent summary produced by the National Council of State Housing Agencies (NCHSA).

- Proposed 9% credit allocation increase: 25% in both 2022 and 2023 would raise the per capita allocation amount from $2.81 per capital to about $4.75, or **about $3.5 billion per year over the two-year period**. That is also before any annual increase due to population or CPI growth.

- Basis boosts increase equity available to projects that are in high development cost areas or Qualified Census Tracts. The AHCIA would greatly expand the number of projects that would be eligible for a basis boost. The basis boost provision would increase the feasibility of many projects as well as the overall supply of LIHTCs. For a more detailed breakdown of the basis boost provision, please visit this analysis by Novogradac.

- Reduction in the 50% test for tax-exempt bond transactions to 25%. Under current law, if more than 50% of aggregate eligible basis is financed with tax-exempt bonds, a property owner is eligible to claim the 4% credit without receiving an allocation from the state allocating agency's LIHTC volume cap. This change would free up an estimated $93 billion in state PAB capacity over 10 years according to the Affordable Housing Tax Credit Coalition (AHTCC) and effectively double the amount of projects that could be financed with tax-exempt bonds, increase the efficiency & utilization of the limited amount of PAB at the state level and **potentially increase the size of the overall LIHTC market dramatically.**

- Creation of the Middle-Income Housing Tax Credit (MIHTC). The creation of MIHTC would create a new 5-year housing credit based on $1.00 per capita that would support the construction of housing that serves households with incomes ranging from 60% to 100% of AMI. As proposed, the MIHTC would work in conjunction with LIHTC and any unused MIHTC allocation could be used as additional 9% LIHTC allocation. Based on the U.S. population of approximately 330 million people, this would **add roughly $1.65 billion of tax credits over a 5-year period**, some portion of which may end up being used for LIHTC.

In addition, there have been special LIHTC allocations for Federal Disaster Area relief in recent years. As a result of severe wildfires & floods that occurred, Congress allocated additional LIHTC's to affected states, most recently in the range of $1.2 billion. There have been discussions around making disaster credits automatic when a federal disaster is declared, but regardless of whether that specific mechanism comes to pass, Congress likely will be allocating additional disaster relief credits in the future.

Demand

While we expect an increase in demand in 2022 as noted above, if all of the above provisions of the AHCIA are enacted, this increase will not be sufficient to offset the increase in supply. Here are the key components of additional demand looking ahead to 2022.

Fannie Mae and Freddie Mac currently account for about 5% of the LIHTC market and their budgets limit LIHTC equity investments to $500 million per year, respectively. Both are under the oversight of the Federal Housing Finance Agency (FHFA). Based on a recent U.S. Supreme Court ruling, the Biden Administration is able to replace the Director of FHFA. Based on indications from the National Economic Council, which advises the Biden Administration on economic policy, it is our expectation that the GSEs LIHTC investment authority will double in 2022. **If this materializes, demand from the two GSEs alone will increase by $1 billion in 2022**. While this increase in demand is significant, they will still account for less than 10% of the equity market. 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 would likely need to increase staffing levels, and therefore their increased appetite may be realized over time instead of immediately.

Several insurance companies will combine to increase annual demand by $500 million per year or more. One had been investing approximately $300 million annually in LIHTC, but paused new investments during the pandemic. Our expectation is that they will return to the market, in some capacity, during the second half of 2021. A second insurance company is planning to return to the market on a programmatic basis after a more than five-year hiatus at around $200 million per year. 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.

Banking consolidation continues to drive LIHTC demand as well. Over the years, we've seen increased CRA activity, including LIHTC investment, leading up to mergers and acquisitions in the banking community as they often strive to reach or maintain "outstanding" CRA ratings helping to pave the way for such activity. Once mergers are announced, the new entity then typically makes a CRA commitment which is larger than their previous separate CRA activity combined. There have been almost a dozen sizeable mergers of banks who are active LIHTC investors in 2020 and 2021 alone.

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

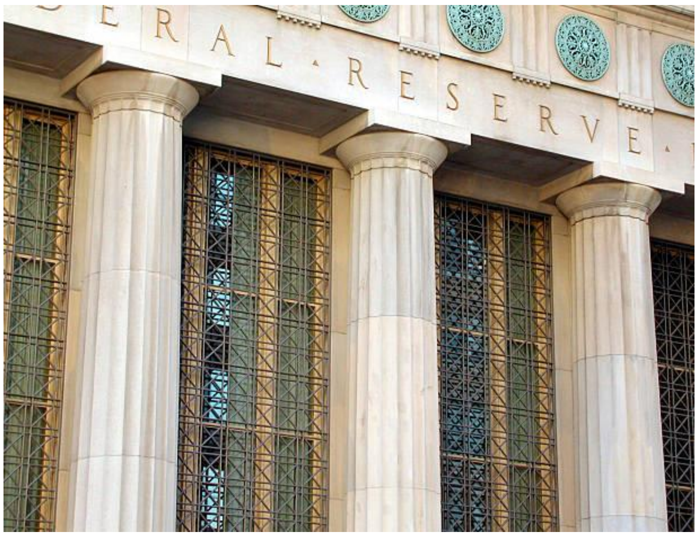
The Federal Reserve has been committed to doing whatever is necessary to support the economy through the pandemic and the response to COVID-19 has been historic. The overnight federal funds rate remains at its record low range of 0.0%-0.25%, and the Federal Reserve has returned to a program of quantitative easing to promote low interest rates. All of this has helped buoy the stock market despite the pandemic's impact on the economy.

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. Since January, when we reported the 10-year at 1.12%, yields continued to rise into March and April. Since that time, yields have slid back down and currently sit at about 1.38% as we go to press. As a result, the spread to LIHTC investments has remained above the long-term historic average.

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 440 bps. Using a non-CRA 6.25% after-tax QIRR from the most recent round of closed multi-investor funds, today that spread is above historic norms at approximately 516 bps, a favorable spread not seen since 2010-2013.

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 310 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 June 29, 2021, BBB's sit at 2.24%, the resulting after-tax equivalent spread to LIHTC has increased to 448 bps.

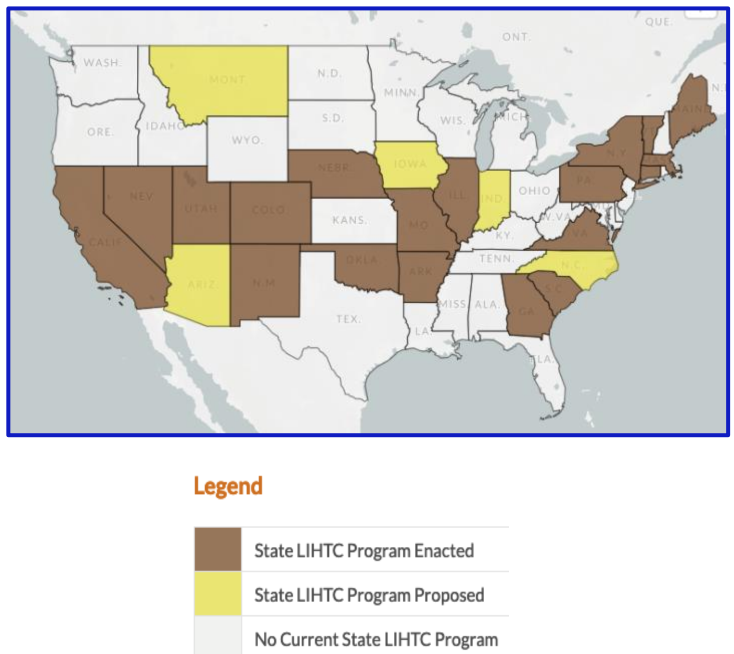
Please see our attached exhibits for graphical representations of our yield data.



What does this all mean? LIHTC equity investments continue to offer excellent risk-adjusted returns which are currently well above historic averages. The asset class can also be a cornerstone to any company's ESG or social impact investment initiatives. We view it as likely that supply will increase faster than demand in 2022, which will result in falling credit prices and rising yields. This will further improve LIHTC's attractiveness relative to alternative investments. When combined with the prospect of higher corporate tax rates and the expectation that LIHTC will be able to offset both the global minimum tax and minimum "book" tax for large corporations, the case for LIHTC equity investments seems to be particularly compelling.

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, NV, NY, OK, UT, and VT. There are state credit programs being proposed in AZ, MT, IA, IN & NC as well.



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. To see an outline highlighting the particulars of each state's program, follow this link.

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.

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.

So far in 2021, there have not been any traditional secondary sales of significant size to impact the primary market. In fact, secondary activity seems to be relatively quiet, perhaps in anticipation of higher corporate tax rates that will make the value of LIHTC investments rise as the tax deductions become worth more. We continue to hear of a number of programmatic bank-to-bank sales, but to date, nothing on a large scale to impact pricing.

CRA Reform & Modernization

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.

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 Funds

Preservation funds have generally mirrored the pricing and underwriting trends we've been discussing for the LIHTC market. That is to say that pricing improved and yields rose modestly over the past twelve months. There has been a similar flight to quality transactions and somewhat decreased investor demand. We expect returns and demand to follow the broader trends we have been discussing for 2021. Occupancy and rent collection trends have been similar as well.

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 have 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.

These funds have different investment models (e.g. acquisition versus joint venture) and sourcing strategies (existing developer networks, on-market transactions, off-market transactions, etc.) and fall along a spectrum as it relates to qualifying as a PWI. Currently, banks make up the majority of investor equity as investments in some of these funds qualify for their CRA investment test (and lending test if also providing debt to the fund). Other investor cohorts include a limited number of insurance companies as well as endowments, foundations, family offices and high net worth individuals. Investments by insurance companies have been limited presumably because of risk-based capital charges relative to returns, but interest seems to be increasing.

Unlike LIHTC funds where properties are largely specified to the fund prior to investor equity closing, preservation funds are typically less specified during the marketing period. As a result, CRA investors may have to get comfortable making capital commitments without specific properties for CRA identified at closing. Subsequent geographic CRA targeting by the fund sponsor is often done on a best-efforts basis.

We currently work with a number of fund sponsors and, similar to the LIHTC market, pricing appears to have adjusted downward in the wake of the pandemic. According to one of our sponsors, they were seeing an uptick in the number of available transactions and a 5-10% downward price adjustment for transactions with a value-add strategy (i.e. strategic renovation to maximize net *operating income) in 2020. In contrast, they reported increased demand for properties with government rental assistance and strong "core" transactions (i.e. the best properties in the best markets). Investor demand softened somewhat during 2020 and into 2021. We saw fewer funds and somewhat smaller fund sizes in 2020 and expect a similar environment in 2021. Partially offsetting the more conservative approach to value-add strategies is the availability of significantly lower mortgage rates, particularly HUD (Fannie/Freddie) debt.*

Across these sponsors, multi-investor fund sizes range from $50 million to $1.5 billion with $100-200 million being more typical. 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. We are assuming yields may continue to trend up, though not dramatically, in the second half of 2021.

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. As highlighted earlier, the specter of declining rent collections still looms for 2021 without additional federal fiscal support.

See state-by-state eviction extensions, some beyond 1/31/21

Wrap Up

We will send out an updated summary of fund offerings at the end of Q3 to capture any pricing changes before our next newsletter in early January. 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. If you would like to be removed from our mailing list, just let us know.

You can reach Dave Robbins at 617-340-7040

& Brian Rajotte at 503-575-9232.

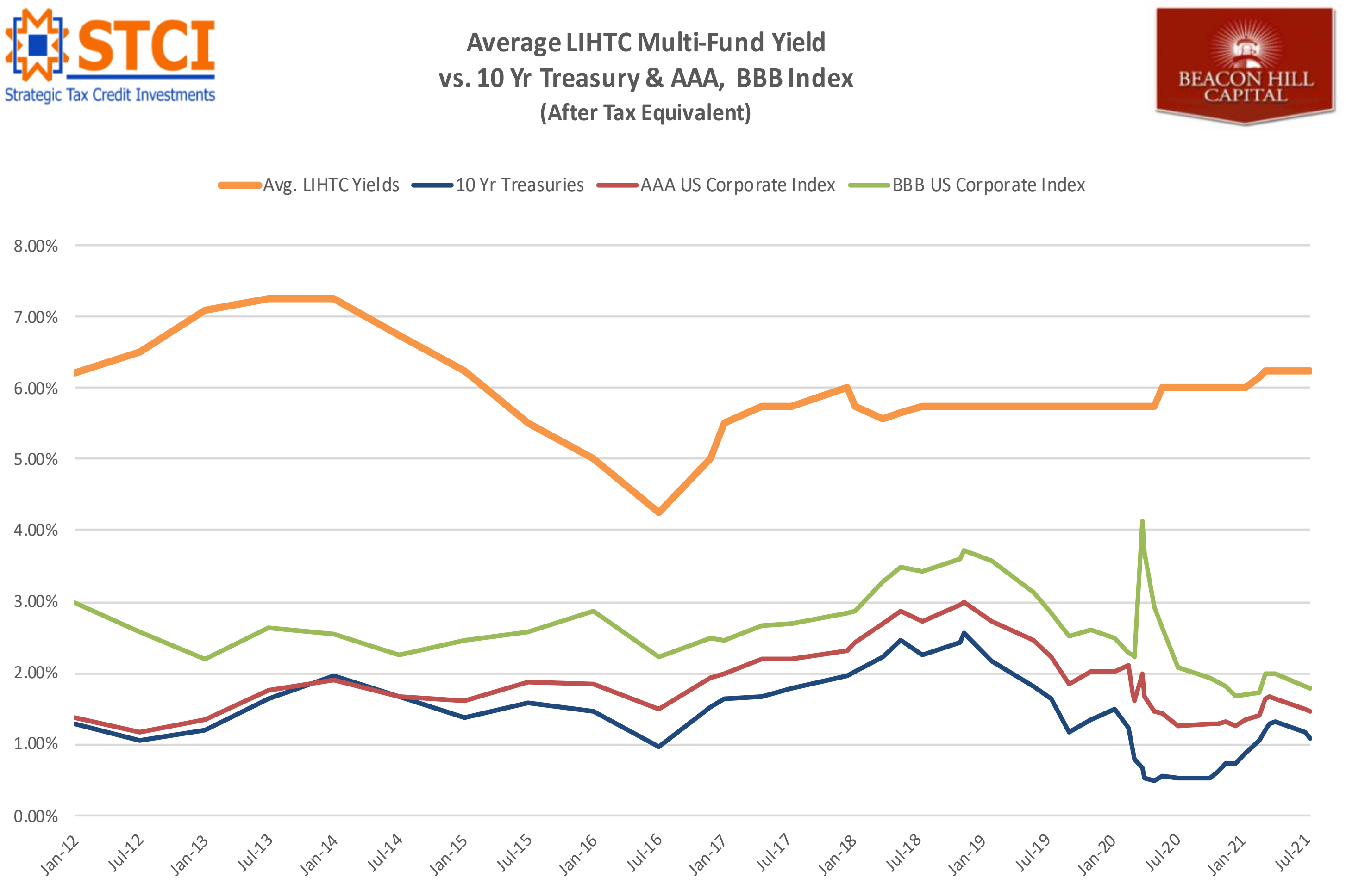
StrategicTaxCreditInvestments.com

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

Beacon Hill Capital at 781-740-8981.

bhcapital.com

LIHTC Yields vs. Alternatives



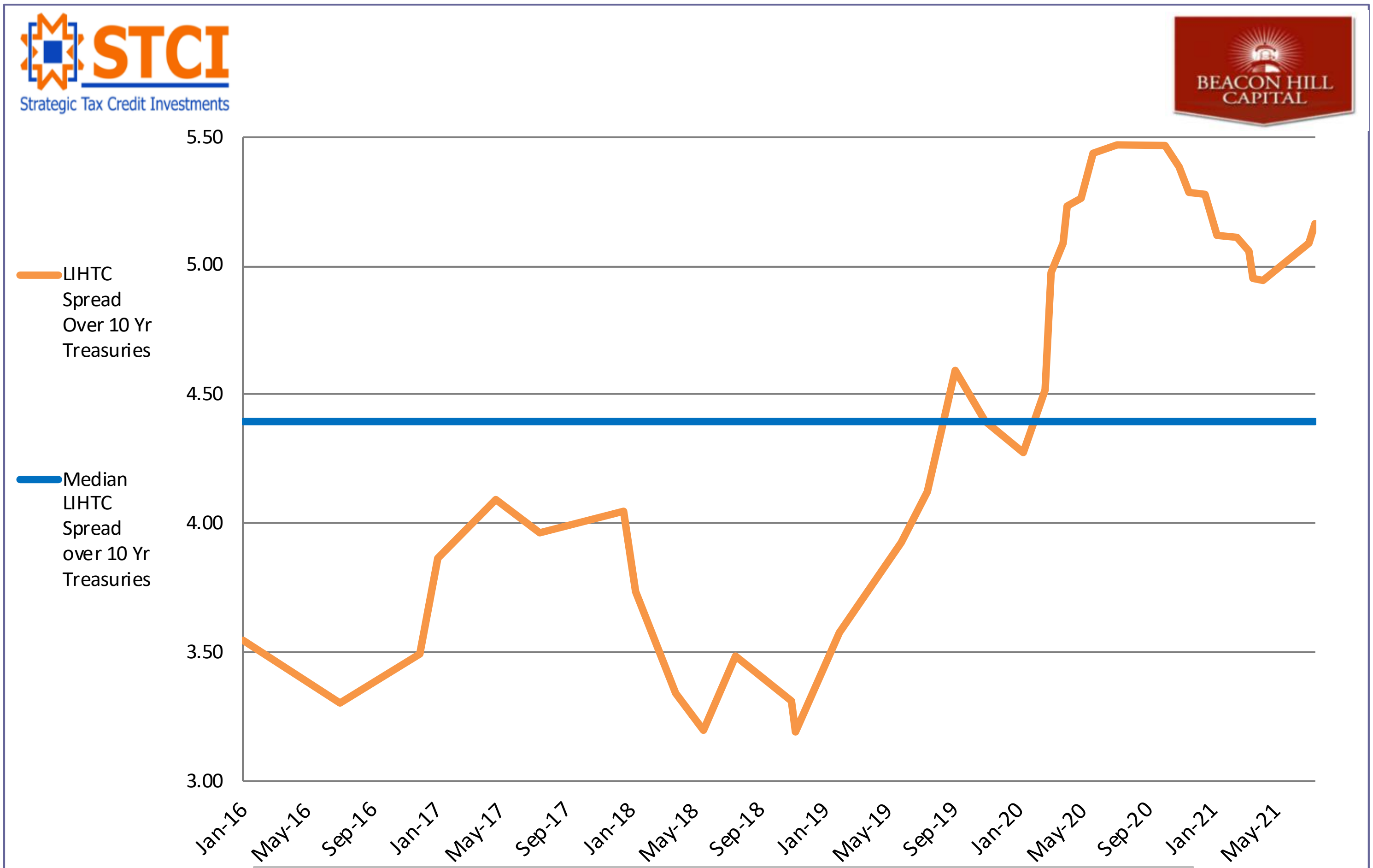
Notes: 35% Tax Rate for pre 2017, 25% for 2017, 21% for 2018-present

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
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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
Q3 2021

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	107	July	160	Available	6.60% $0.939 >=$45M	6.50% $0.942 >=$35M		6.00% $0.950 Base	4.50% TBD TBD	5.50% TBD CRA		33%	41% / 59%	62% / 38%	97%	March launch, 62% new construction, 84% repeat developers, $0.939 price per credit
CREA	88	Dec	300	Prelim	6.75% $0.960 >=$50M	TBD TBD >=$25M	TBD TBD >=$20M	TBD TBD <$20M	TBD TBD CRA I	TBD TBD CRA III	TBD TBD CRA IV	<33%	47%/53%	TBD	TBD	Preliminary info. 100% specified, 27 properties in 16 states. Approximately 75% new or gut rehab, 90% repeat developer, 30% senior or special needs tenancy.
Enterprise	35	May	236	Closed	6.35% $0.920 > $45M	6.25% $0.930 < $45M	6.15% $0.930 < $30M	6.00% $0.940 < $20M	6.00% N/A CRA	4.50% N/A CRA	3.60% N/A CRA	35%	32% / 68%	71% / 29%	96%	20 properties in 14 states. 70% repeat developer. 40% units Sec 8 subsidy. 24% of equity senior tenancy
PNC	80	June	155	Closed	6.50% $0.929 >=$30M	6.00% $0.947 <$30M	5.75% $0.956 Base	5.00% $1.00 CRA	4.50% $1.020 CRA			32%	44% / 56%	76% / 24%	90%	Accelerated ramp up of credits due to secondary product, 10% Co-investment by PNC Bank
RBC	31	May	207	Closed	6.25% $0.960 >=$25M	6.00% $0.960 >10 <25M	5.75% $0.960 < 10M	5.00% TBD CRA	4.25% TBD CRA	4.00% TBD CRA	3.85% TBD CRA	35%	40% / 60%	76% / 24%	124%	27 properties, 16 states. > 50% of equity has some rental subsidy, 71% repeat developer. CRA fund tiers account for 54% of equity and also includes tiers at 4.75% and 4.15%. 100% under LOI/closed
Red Stone	90	Dec	200	Available	6.75% $0.939 >=$25MM	6.50% $0.931 >=$25MM	6.00% $0.962 >=$10 <$2	5.25% $0.988 <$10MM				27%	42% / 58%	65% / 35%	108%	6.50% IRR is cash needs; 6.75% IRR is bridged. 16 properties in 13 states. 80% under LOI. Rental subsidy on 48% of units. 28% senior properties. 75% repeat developer.
Richman	135	July	220	Closing	6.50% $0.930 >=$25M	6.00% $0.950 <$25mm	5.50% TBD CRA	4.00% TBD CRA				39%	38% / 62%	49% / 51%	104%	90% of hard debt covered by rental subsidy, 28 properties, 60% Under LOI, 97% repeat developers
Stratford	31	April	186	Circled	5.85% $0.953 >= $25M	5.40% $0.940 >=$25M*	5.00% $0.960 >10 <25	5.00% < $10M				36%	72% / 28%	73% / 27%%	81%	20 properties in 12 states. 57% senior tenancy. 74% repeat developer
WNC	51	August	110	Available	6.50% $0.940 >$25mm	6.25% $0.915 $25M, cash	6.00% $0.920 < $25M	TBD TBD CRA				27%	42% / 58%	82%/ 18%%	91%	18 properties in 11 states. 70% repeat developers. Portfolio includes units for special needs tenants including formerly homeless, disabled veterans, developmental disabilities and frail elderly

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

This information does not constitute an offering. All information subject to change.

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STCI Strategic Tax Credit Investments

BEACON HILL CAPITAL

LIHTC Fund Market Overview

Q3 2021

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	112	Circled	6.00%	5.50%	5.00%	4.00%		26%	100% specified. 7 properties; 81% closed; 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	Nov	130	Available	6.25%	5.50%	5.00%			34%	7 properties. 80% under LOI. Rental subsidy on 67% of units. 40% senior properties. 100% repeat developer.
					$0.947	$0.973	$0.992				
					>=$25MM	>=$15 <$25	<$15MM				
WNC	CA 19	July	83	Closing	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			

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Strategic Tax Credit Investments

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BEACON HILL CAPITAL

Preservation & Workforce Housing Funds

Q3 2021

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	2021	3/7	1.5%	100	8.00%	11-14%	2% to 5%	$3M	75.00	Q1 2021 Launch. 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	2021--2022	4 / 10-12	1.5-2.0%	1500	7.00%	10-12%	2% up to $10M	$250K	est 1B	$310M equity closed, circled interest total approx. $700M. 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	2021	3/5	2%	100	7.00%	11.00%	up to 24.99%	$5M	150.00	Q2 2021 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	2021	3 / 8	1.5%	75	8.00%	11-13%	5% up to $1.5M	$2.5M	50.00	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.