LIHTC in 2009:
Re-engineering and rethinking the value chain

"Sister Mary Elizabeth Explains The Current Chaos To You"

CAS FINANCIAL ADVISORY SERVICES

Why the system broke; and why it needs fixing

CAS PARTNERS

David A. Smith, CEO

NH&RA Summer Retreat

The changing marketplace: Macro trends operating for at least half a decade

- Shifting gravity of resource allocation/ decision-making
  - From HUD
  - Through the states
  - To Wall Street
  - Back to Washington (via TARP)?
- From capital consumers (deals) to capital providers (money)
- Consolidation in the financial sector
  - As the customers get bigger, their service providers get bigger
  - Outsourcing after RIFs (or job-o-suction)
- Maturity and specialization
  - Sophisticated linked value chains and distributed activities
- The rediscovery of risk, and the rediscovery of a premium for the best talent

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Introducing CAS Financial Advisory Services
(The artist formerly known as "Recap Advisors")

- What we do: Manage $5.0 billion of multifamily assets
  - Asset management, capital providers
    - Debt side: High-coupon non-performing tax-exempt multifamily bonds
    - Debt side: Development-condo loans
  - Transactions, Starrett City, Church Park
  - Advisory: state HFAs, sellers and buyers of structured assets
  - Capital planning (via the On-site Insight label)
    - National HUD public housing 'portfolio baseline' survey
- Who we are: Proven specialists in multifamily finance
  - Founded 1989, now part of the CAS Partners platform
  - Over 800 transactions successfully executed
  - Experienced and continuing executive leadership
    - Smith, Trehubenko, Booth, Handelman, Lowry
- How we do it: "Skate to where the puck is going to be"
  - Thought leadership, industry and government seminars
  - *State of the Market*, monthly
  - *Financial Advisory Update,* as events warrant
    - To subscribe, email me: dsmith@casfas.com

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LIHTC delivery is an integrated value chain with seven steps, two of which come 'out of order'

The LIHTC value chain

1. Sponsor identifies and conceives a transaction, and secures site control.
2. Sponsor secures a forward commitment for permanent debt.
3. As required (usually), Sponsor also secures soft debt commitments.
4. Sponsor applies for LIHTC allocation.
5. Sponsor wins LIHTC allocation.
6. Sponsor secures equity commitment.
7. Sponsor closes financing, acquires land, starts construction/ rehab.

- The value chain is bass-ackwards
  - The critical missing piece – securing equity commitment – occurs late in the process
  - Long after the sponsor has had to make a major reliance decision (soft debt commitments) predicated on a particular price

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LIHTC has unique features not replicable in appropriated programs

1. Risk transfer
   - Government pays funds only after the property is built (not before)
   - Private sector bears entire non-completion risk
   - In appropriations, government writes a check up front

2. Collectible recapture
   - Recapture takes money not from the property but from a 'bystander' (the investor)
     - Ergo, instantly and fully collectible (and no flinching!)
   - Appropriated programs take money from the property
     - Tenants become economic 'human shields' against enforcement
   - Appropriated programs take money from the sponsor
     - Non-profits become political 'human shields' against enforcement

3. Outsourcing administration via 'outcome-based' compliance
   - Pay for results, charge penalties, minimal administration
     - Ergo, property pays its own costs of monitoring (accountants)
     - In appropriated programs, process-oriented (did you follow rules?)

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LIHTC depends on a Stabilized Market

- A Stabilized Market means three conditions are met

1. Every Ask gets a Bid
2. There is a discernible structure to Bids
3. Future Bids bear a smooth-curve relationship to past Bids

- The Stabilized Market existed from 1993 through 2007

- When the market isn't stable, you can't forward-commit

- So the system breaks … and the pipeline is disrupted
  - Currently ~75% of 08 allocations have not closed equity
  - [Our SWAG; your mileage may vary]

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Two public-policy outcomes require two essential roles: allocator and investor

- **Policy = Allocator**
- **Goal: quality public policy outcomes**
- Choose the most socially deserving properties
- Assure long-term housing quality, affordability
- Make maximum use of scarce federal resources
- **Core activity: compliance**
- What they don't do – take over troubled or busted properties

- **Economics = Investor**
- **Goal: receive LIHTC returns as projected**
- Choose the safest (least risky) properties
- Assure long-term housing viability
- Maximize cash flow, residual value
- **Core activity: asset management**
- What they don't do – second-guess policy choices

Each party has come to rely on the other's primacy in its area
This is symbiosis, and it's why LIHTC's record is outstanding

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How allocators and investors can rebuild the value chain

- **Goal: system where quote matches received price**

Allocators
1. Increase cash development fee
2. Eliminate minimum bid requirements
3. Reduce administrative minima, use points
4. Create a flex-source pool (TCAP?)
5. Create a firm-equity fast track (first in wins)

Investors
1. Develop fast-closing flexible acquisition vehicles
2. Make investor requirements clearer to sponsors and allocators
   - Communicate directly with allocators, 'open book'
3. Anticipate the reinvention of CRA

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TCAP and the Exchange:
What they sought to do, and what they're doing

What they sought to do

1. Revive equity demand at a new floor price
2. Protect all pipeline properties

What they involved

- Exchange: trade in unsold LIHTC for cash
  - At 85¢
  - Developers not entitled to return
- TCAP: $2.25 billion of soft loans (via HOME)
  - Roughly 20¢ per pipeline dollar
- Enacted February, 2009

Challenges to TCAP / Exchange

The trade-in price is above-market (85¢ > 72¢)

- Discourages selling their LIHTC
- Developers turning down ready-to-close equity offers

Implementation is slow

- TCAP runs through HUD
  - Numerous issues
- Exchange runs through Treasury

Costs are being added

- States have administrative costs
- Davis-Bacon, Section 504
- NEPA (much more than just Phase 1)

Result: Inhibition and delay

- Inhibits new demand
  - Sponsors hold back product
- Inhibits pipeline
  - Sponsors cannot choose a path

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A possible unpleasant future:
The ghost of LIHTC yet to come?

- Today market is segmenting
  - Tier 1, CRA core zones, **85¢**
  - Tier 2, CRA penumbra, **75¢**
  - Tier 3, good demographics, **65¢**
  - Tier 4, everywhere else, **no bid**
- Projected 2009 volume: 70% absorption
  - LIHTC 'prints' $9.0 billion of new coupons annually
  - Assume 75¢ pricing = $6.8 billion total new equity potential (100%)
  - "Conventional wisdom" on total 2009 volume = $4.5 billion
  - Equivalent to 70% absorption
  - What happens to the other 30%? Which 30% doesn't get sold?
- What will Q4 look like?
  - States must sell 60% of 09 allocation
  - Large unsold inventory in Midwest
  - Program no longer looks national … does it look efficient?
- ARRA implementation delays make closing a challenge
  - "Conventional wisdom" = 9/15/09 before TCAP, Exchange effective

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Summing up …

1. LIHTC is a fantastic system with benefits no appropriated program can match
   – Risk transfer
   – Collectible recapture (with enforceability)
   – Outcome-oriented compliance (easier administration)
2. In 2008, LIHTC's value chain broke
   – Predicated on future pricing matching current pricing
   – When prices hit an air pocket, cannot forward-commit
3. Reconnecting LIHTC's value chain requires conscious work
   – Allocators to guard the public interest, assure compliance
   – Investors to guard the economic viability, assure asset management
4. ARRA is not working (yet?)
   • Reasonable projection is 9/15/09 "able to choose" date"
5. The fourth quarter looks unsettled
   • How will the financing choices be wisely made?
   • How will the deals get closed?

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Questions?

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