The Low-Income Housing Tax Credit Program at Year 25: A Current Look at Its Performance

A REZNICK GROUP REPORT

TAX CREDIT INVESTMENT SERVICES

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Reznick Group

ACCOUNTING ▪ TAX ▪ BUSINESS ADVISORY

Foreword

Major tax legislation with wide-sweeping reforms rarely proceeds through our legislative process. The last such legislation was enacted a quarter-century ago in the form of the Tax Reform Act of 1986 (TRA 1986). The principal goal of that legislation was a formal assault on the proliferation of income tax shelters. TRA 1986 was therefore a remarkably unlikely vehicle for the enactment of a new tax incentive program—the Low Income Housing Tax Credit (the housing tax credit or LIHTC).

The congressional sponsors of the housing tax credit could not possibly have imagined what the consequences of the program would be. During the last twenty-five years, more than 2 million affordable apartments have been built or rehabilitated to house low-income households. The Low-income Housing Tax Credit was somewhat of an experiment when enacted and thus required annual re-authorization for many years. What has developed in the interim is an entire new development infrastructure built on the Program's effective administration by 50 state housing credit agencies and a reasonably efficient capital market which has become the major financing tool for these developments.

A number of studies have been published about the program, examining whether the right tenants are being served, whether the credit was being utilized efficiently and whether the properties developed under its auspices were operating successfully in their local markets. The last study of the Program's property operations was undertaken five years ago. While the results of the studies have been very positive, questions have been raised about whether overbuilt housing markets, unemployment and general economic conditions may have considerably weakened those results. Reznick Group's study was designed to be directly responsive to those questions as it is focused on the economically challenging years from 2008–2010. The results of our inquiries are contained in this report.

REZNICK GROUP, P.C.

Introduction

This is the first in a series of periodic reports issued by Reznick Group, P.C. that address the performance of properties financed with low-income housing tax credits. The housing tax credit program was enacted as a way to stimulate the development of affordable housing for low- to moderate-income families. Over the past twenty-five years, the program has been studied by various interested parties such as the General Accounting Office and various oversight committees to determine whether:

- It was meeting the original intent of Congress
- The right tenants were being housed
- The program could be made more efficient
- It should be made permanent.

Given the scrutiny of all federal income tax expenditures, this is an appropriate time to examine whether housing tax credit properties are meeting their financial obligations and the needs of the markets they serve. While the report was not undertaken for this purpose, the data collected provide most of the information that would be required to assess the housing tax credit program. To compile and analyze the data required for the assessment, Reznick Group requested the participation of 40 investment sponsors and institutional investors. Ultimately, virtually every sponsor of housing tax credit investments and some of the nation's largest investors participated in the survey. For a complete list of participants and contributors, please refer to Appendix A. With the assistance of Integratec, our affiliated real estate services and software solutions company, Reznick Group examined data collected from the financial statements of more than 16,300 apartment properties. While Reznick Group examined operating data for every LIHTC property without regard to the year a property was placed in service, particular focus was placed on the manner in which LIHTC properties performed during the challenging period 2008–2010. For a more extensive discussion of the methodology employed to collect and analyze property data, please refer to Appendix B.

An extensive second report, to be issued in the fourth quarter of 2011, will examine whether and to what extent the provisions of the Community Reinvestment Act affect the price at which housing tax credits "trade" based on property location. The second report will also:

- Provide additional analysis of the difference in LIHTC property performance based on location (by state and region)
- Analyze the fundamental reasons why certain properties underperform

While the scope of our work differs from the scope of other studies of the housing tax credit program, we acknowledge the contributions such studies have made to increasing public understanding of how LIHTC properties are financed and operated. The housing tax credit program, notwithstanding its successes, is complex in numerous ways and can be challenging to explain to a wide audience. We are grateful to the many firms that supported Reznick Group's effort in promoting a deeper understanding of the housing tax credit program, its strengths and weaknesses and the critical role it plays in the development of affordable housing.

REZNICK GROUP, P.C.
AUGUST 2011

Report Restrictions

Reznick Group has used information gathered from the participants listed in Appendix A to compile this study. The information provided to us has not been independently tested or verified. As a result, we have relied exclusively on the study participants for the accuracy and completeness of their data. No study can be guaranteed to be 100% accurate and errors can occur. Reznick Group does not warrant the completeness or the accuracy of the data submitted by study participants and thus does not accept responsibility for your reliance on this report or any of the information contained herein. The information contained in this report includes estimations, approximations, and assumptions and is not intended to be legal, accounting, or tax advice. Please consult a lawyer, accountant, or tax advisor before relying on any information contained in this report. Reznick Group disclaims any liability associated with your reliance on any information contained herein.

To ensure compliance with the requirements imposed by the IRS, we inform you that any U.S. federal tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing, or recommending to another party any transaction or matter addressed herein.

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CHAPTER 1

Executive Summary

Overview

The Low-Income Housing Tax Credit program reached the 25th anniversary of its enactment in 2011. Adopted in the midst of dramatic changes to the Internal Revenue Code in 1986, the program has since enjoyed a strong level of bipartisan support in the Unites States Congress. Following are some of the many features that make the housing tax credit program unique.

- The cost of the housing tax credit program to the federal government is fixed and determinable by statute. The program is subject to a volume limit that permits its cost, unlike most tax expenditures, to be calculated with precision, thus ensuring that it cannot become a "runaway" government program.

- Housing tax credits are divided among the states based on their respective populations. The determination of which projects are to be awarded housing credit allocations is made by state housing credit agencies pursuant to a set of highly transparent procedures. As a result of its local control, the program has proven to be adaptable enough to serve changing housing needs as established by the states rather than by the federal government.

- For the last 15 years, the demand for housing tax credits has exceeded supply almost every year. This imbalance between the supply and demand for housing credits has resulted in a highly efficient use of tax credit dollars as a tool to finance the construction of additional affordable housing.

- Over the course of the past decade, the occupancy level in housing tax credit properties has consistently been approximately 96%. Given the normal turnover of rental units, this means that housing credit properties are effectively fully occupied. An inventory of 25,000+ fully occupied properties is directly attributable to a national shortage of affordable housing. The traditional measure for severe rent burden is when more than 50% of household income is required for housing. In 2009, 19.4 million U.S. households fell into this category[1].

- In addition to the LIHTC program, there are other federal housing programs designed to maintain the affordability of rents for low-income tenants. The LIHTC program is unique because it functions as a capital subsidy to stimulate the production of *new* affordable housing.

For these and other reasons, the housing tax credit program has been, by any measure, a resounding success. Previous studies of the housing tax credit program have documented the program's favorable record of:

- Serving income-qualified tenants at restricted rents
- An exceedingly low number of properties being lost to foreclosure
- Maintaining high levels of occupancy.

[1] Source: Joint Center for Housing Studies of Harvard University. *"The State of Nation's Housing 2011."*

At the same time, however, virtually every housing tax credit property operates on a paper-thin cash flow margin. The level of cash flow that housing tax credit properties generate is artificially constrained by statutory rent restrictions and the fact that state housing credit agency allocators are required to award qualified properties only enough housing tax credits to make them financially feasible.

The housing tax credit program has historically demonstrated a strong track record of delivering quality housing to low-income families, meeting the expectations of institutional investors and maintaining an annual foreclosure rate that is less than 1%, as is more fully described in the report. State housing credit agencies are statutorily obligated to award only enough housing tax credits to make potential developments financially feasible and the allocators have been effective at ensuring that projects to which they award housing credits have not been over-financed. One consequence of this practice is that housing tax credit properties are underwritten with very little margin for error in generating sufficient net operating income. Accordingly, when operating expenses are higher than projected or when rents are marginally lower than expected, many housing tax credit properties generate just enough or slightly less cash flow than is needed to service mortgage debt. In recent years, as much as 35% of all housing tax credit properties were operating below break-even, albeit often by fairly small amounts.[2] At the same time, studies have confirmed that the rate of foreclosure for housing tax credit properties has been very low in the aggregate. The apparent contradiction between these data points has been analyzed in other affordable housing performance studies and will be reassessed in the expanded phase of this report scheduled for release in the last quarter of 2011.

The tension between these two economic realities has left some investors with the impression that LIHTC investments are riskier than was previously understood. The concern held by some parties with respect to this issue has been further exacerbated by the challenges to the national economy occasioned by the near meltdown of the financial services sector and the negative economic developments that followed it. Addressing the question of whether the number of struggling LIHTC properties may have increased and whether the incidence of foreclosures has increased in the past three years is the central objective of Reznick Group's report. Our analysis of the data suggests that there has been no material deterioration in LIHTC property performance and that certain operating performance metrics significantly improved from 2008 to 2010.

Survey Findings

Reznick Group achieved strong industry participation in its efforts to compile operating data for this report. Nearly every active housing tax credit syndicator and a number of the largest investors in the nation provided Reznick Group with data from the LIHTC investments they had sponsored or made since 1987 in addition to providing financial support.

Respondents provided Reznick Group with operating data for 16,356 housing credit properties, 90% of which had achieved stabilized operations as of December 31, 2010. Of the data cohort representing the aforementioned 16,356 properties:

[2] Source: Ernst & Young. *"Understanding the Dynamics V"*

- Investors are projected to receive approximately $69 billion in housing tax credits from the properties included in the survey and have contributed approximately $60 billion in equity to finance property development.[3]

- The properties surveyed attracted an estimated additional $27 billion in first mortgage financing from conventional lenders.

- The federal government's LIHTC "investment" stimulated $87 billion in private sector capital ($1.23 of debt and equity per $1 of housing tax credit) for the development of affordable housing. The $1.23:$1 ratio above does not include a significant level of additional debt financing for these housing tax credit properties that came from state and local governments and a variety of other sources.

Our analysis of housing credit property performance is based on the three most important metrics for measuring property operations: occupancy, debt coverage and net cash flow. Reznick Group reports the following operating results from the data collected from respondents:

- Housing tax credit properties typically require economic occupancy of at least 87–89% (or physical occupancy of approximately 89–91%) to attain break-even operations. In recent years, occupancy in housing credit properties has reliably averaged approximately 96%. Notwithstanding the national recession and sharp increase in unemployment, occupancy in housing credit properties averaged 96.4%, 96.3% and 96.6% in 2008, 2009 and 2010, respectively. As previously noted, occupancy rates are another indicator of the tremendous imbalance between the increasing demand and short supply of affordable housing properties.

- The debt coverage ratio for housing tax credit properties has hovered between 1.13 and 1.15 for a significant portion of the past decade. The data indicate that debt coverage ratios climbed from these levels to 1.19 in 2009 and 1.24 in 2010. Reznick Group suspects that the increase in these ratios is largely attributable to several factors including the increasing number of housing tax credit properties that have been financed with little to no hard debt, the impact of higher housing credit prices on the equity/debt mix in housing tax credit properties and the fact that a significant number of properties reported higher rental income.

- Annual net cash flow averaged $200–$250/apartment unit in recent years. Cash flow per apartment unit reached $246 in 2008, increased to $335 in 2009 and reached $412 in 2010. While the improvement in property-level cash flow may initially appear dramatic, Reznick Group notes that, in practical terms, cash flow per apartment unit increased by about $8 on a *monthly* basis in 2009 and by an additional $6 per month in 2010. As a general matter, debt coverage ratios and net cash flows operate in parallel fashion. Reznick Group will examine the improvement in both metrics in greater detail in our expanded report to be released in the last quarter of 2011.

[3] The net equity and credit figures are understated in value and slightly mismatched because of missing data in either or both respondent fields. We estimate that overall, the Housing Credit Net Equity figure is understated by approximately $1 billion while the Total Housing Credits figure is understated by roughly $1.7 billion.

- Reznick Group prepared preliminary analyses of the manner in which metric variances are distributed according to segmentation by property type, property age, and newly constructed property as opposed to rehabilitation projects, in addition to other segmentation analysis. Reznick Group has not observed any material differences in operating results based on these segments. Historically, the most significant differences in such metrics have been attributed to geographical distinction on a regional or state-by-state basis. Reznick Group will examine whether and how the metric differences may have changed from 2008–2010, as part of the expanded report to be published in the fourth quarter of 2011.

- In addition to studying operating performance for the entire cohort of surveyed properties, Reznick Group adhered to current industry practice for isolating performing as opposed to underperforming properties. As a general matter, we distinguish properties as underperforming when they report occupancy levels below 90% and/or debt coverage ratios below 1.0. It was within this segment of underperforming properties that Reznick Group observed the most significant change in operating results for 2008–2010.

- The percentage of underperforming properties that report occupancy challenges has been perhaps the most volatile of the data points analyzed on a year-to-year basis. Prior to 2008, the percentage of properties reporting below 90% occupancy (on a net equity versus property count basis) ranged from a low of 11.5% to a high of 18%. However, the percentage of properties reporting below 90% occupancy dropped to 11.5% in 2008, increased slightly to 12.5% in 2009 and decreased to 9.3% in 2010. This statistic may surprise some who expected overbuilt housing markets in certain parts of the country to negatively impact occupancy in LIHTC properties. Reznick Group observed areas where the owners of market-rate properties (i.e., those not subject to any income or rent restrictions) have reduced their rents to levels approaching the rates being charged in LIHTC properties. Similarly, there are certain markets, particularly in the Midwest, where the inherent rent advantage between housing tax credit and market-rate properties has been fairly nominal. Reznick Group observed continued chronic occupancy challenges in some of these markets.

- Paralleling the increase in occupancy in 2010, the percentage of properties reporting negative cash flow and/or negative debt coverage actually decreased from 2008 to 2010. The percentage of properties operating below break-even, which has traditionally been the statistic of greatest concern for many investors, has been as high as 35%, and based on the data collected, was 33.7% in 2008, 28.3% in 2009 and 25.2% in 2010. This is a favorable trend, particularly in a challenging economic environment. It is likely that a number of factors are driving the reduced level of negative-coverage properties. These factors are highlighted in this report and will be analyzed more fully in the 2011 expanded report.

- The vast majority of housing tax credit properties that slip into one of the underperforming categories do so for just a year and return to profitable operations in the following year. Properties that report occupancy and cash flow challenges for three or more consecutive years (“chronic” underperformers) are therefore fairly unusual. In some cases, such properties cannot struggle back to break-even despite changing property management companies, funding large deficits for multiple years or trying to restructure property debt. These properties have “structural” deficits because of serious physical plant issues, high area crime rates or similar issues that cannot easily be corrected.

- Measured against the total pool of underperforming properties, Reznick Group's data suggest that the percentage of properties reporting underperformance from 2008 to 2010 was 13.6% for negative coverage and just 3.8% for occupancy rates below 90%. The number of chronic underperforming properties has clearly decreased in recent years—another trend that deserves further analysis.

- Historically, a great deal of attention has been given to the relatively small number of housing tax credit properties foreclosed upon by their lenders. It appears that this particular data point may have been understated, in part due to some of the larger syndicators using their own capital to support troubled properties in order to avoid foreclosure. This practice became less prevalent from 2002–2006 when equity became relatively easy to obtain. As a result, the rate of foreclosures in housing tax credit properties has increased in small increments in recent years. The respondents Reznick Group surveyed reported that 98 of the total property count of 16,399[4] (of which 15,868 were placed in service by the end of calendar year 2010) experienced foreclosure through the end of 2010—an aggregate foreclosure rate of 0.62% measured by property count. Approximately 50% of the stated foreclosures were reported to have occurred from 2008–2010. Thus, while operating performance generally improved, the rate of foreclosure from 2008–2010 increased, suggesting that challenging economic conditions may have disproportionately affected chronically underperforming properties during those years.

- Clearly, the number of foreclosures has been underreported as a result of incomplete data. Over the past ten years, a minimum of eight syndication firms closed operations or became inactive. Reznick Group believes, on the basis of anecdotal evidence, that some of those firms experienced a disproportionately higher incidence of foreclosures. We were not able to pinpoint the number of foreclosed properties syndicated by these firms nor were we able to ascertain the total number of properties ever syndicated by these firms. As a result, any attempt we might make to estimate the impact that the property portfolios syndicated by these firms might have on the industry foreclosure rate would require speculation on our part. Rather than abandoning the methodology Reznick Group adopted to undertake this study, and compromise its results, we have confined the scope of our observations to the results we received from study respondents. Based upon respondents' data, while the number and rate of foreclosures increased incrementally from 2008–2010, the incidence of foreclosures in housing tax credit properties continues to compare very favorably with the foreclosure rate of market-rate multifamily properties and other real estate asset groups.

[4] Total property count for the purposes of foreclosure analysis is slightly higher than the total property count for the rest of the report due to the fact that some foreclosed properties have been disposed of by respondents. Accordingly, no operating data was provided.

CHAPTER 2

Portfolio Performance

Reznick Group solicited data from 40 currently active housing tax credit syndicators and investors, herein referred to as "data providers" or "respondents." This report summarizes the operating and financial data collected from the respondents representing 16,634 housing tax credit property investments located in each of the 50 United States, the District of Columbia, Guam and Puerto Rico. Of the 40 syndicators and investors, 32 (see Appendix A) participated in the study, yielding an overall response rate of 80%. The respondents provided all data to Reznick Group on a voluntary and strictly confidential basis.

In an effort to avoid the administrative burden of reconciling property investments held in the syndicators' and investors' shared portfolios, we collected only direct investment and fund investment performance data from investor participants. After excluding property investments where the equity investment was split across multiple funds, the data Reznick Group gathered represents 16,356 housing tax credit properties, which we believe to be approximately 65% to 70% of the entire inventory of housing tax credit projects. As can be observed in Figure 2.0.1, the 16,356 properties collectively represent approximately $60 billion in housing credit net equity investments and $69 billion in housing tax credits.

Of the 16,356 properties, 14,700 (90%) reached "stabilized operations" as of December 31, 2010. For purposes of this report, the standards used to define "stabilized operations" are: construction must have been completed on the properties, the properties achieved 100% tax credit qualified occupancy (i.e., when all of the tax credit units have been occupied by income-eligible tenants) and the project has closed its permanent financing. Reznick Group recognizes that, although the definition of "stabilization" may differ slightly among industry participants, the industry consensus as a whole suggests that the differences tend not to be significant enough to distort our analysis. As observed in Figure 2.0.1, the 14,700 stabilized properties collectively represent approximately 83% of the survey sample on a housing credit net equity basis. Stabilized properties included in this report averaged 71.4 apartment units per property, $3.4 million in net equity investment and $3.9 million in total housing credits. In Chapter 4, a description of the survey portfolio composition by property age and other characteristics is presented.

Overall Portfolio Composition

FIGURE 2.0.1

	SURVEY TOTAL	STABILIZED PROPERTIES	% STABILIZED
Number of Properties	16,356	14,700	89.9%
Number of Units	1,191,198	1,049,723	88.1%
Housing Credit Net Equity	$ 59,949,803,149	$ 49,704,360,906	82.9%
Total Housing Credits	$ 69,112,707,921	$ 56,811,046,194	82.2%

Reznick Group measured the real estate performance of housing tax credit properties by using a number of operating and financial metrics such as:

- Occupancy (both physical and economic; the latter takes into account issues such as collections losses)
- Debt coverage ratio (DCR), defined as net operating income less required replacement reserve deposits divided by mandatory debt service payments
- Per-unit cash flow, defined as available cash flow after deducting debt service payments and required replacement reserve contributions
- Noncompliance issues related to the property
- Incidence of default or foreclosure.

This chapter summarizes the operating performance data derived from 14,700 stabilized housing tax credit properties during calendar years 2008–2010. The following table summarizes 2008–2010 calendar-year analysis for median physical occupancy, DCR and per-unit cash flow data of the complete stabilized portfolio represented in the report. While occupancy remained consistently strong from 2008 to 2010, DCR and per-unit cash flow trended upward in 2009 and 2010.

Overall Portfolio Performance (2008–2010)

FIGURE 2.0.2

	2008	2009	2010
Median Physical Occupancy	96.4%	96.3%	96.6%
Median Hard Debt Coverage Ratio	1.15	1.19	1.24
Median Per Unit Cash Flow	$246	$335	$412

2.1. Physical Occupancy

Syndicators and investors generally underwrite housing tax credit property investments based on the assumption that "effective" or "economic" occupancy will be 93%. The assumed economic loss of 7% takes into account the periodic turnover of units, the ability to lease such units, and losses due to rent skips and/or collection problems. Figure 2.1 summarizes the median physical occupancy data for the stabilized properties Reznick Group surveyed for calendar years 2008–2010. The data suggest that, notwithstanding the recent recession—the troubled housing sector and increase in unemployment—median occupancy among the surveyed housing credit portfolio remained consistently robust from 2008 to 2010, with only minor fluctuations from year to year. In 2008, the median occupancy rate was reported to be 96.4%, which decreased slightly to 96.3% in 2009 but rebounded and subsequently increased to 96.6% in 2010. The data suggest that more than half of the properties surveyed outperformed their occupancy projections from 2008 to 2010.

Median Physical Occupancy (2008–2010)

FIGURE 2.1

	2008	2009	2010
Median Physical Occupancy	96.4%	96.3%	96.6%

By contrast, the U.S. Census Bureau recently published data suggesting that conventional multi-family properties may have been impacted by the recession. The Bureau reported that the national multifamily rental vacancy rate climbed from 9.7% in 2007 to 10.0% in 2008 and increased further to 10.6% in 2009 before returning to the pre-recession level of 9.4% during the fourth quarter of 2010.[5] The reasons for the difference in occupancy levels are numerous, but the major driver of the consistently high occupancy rates in housing tax credit properties is that the United States simply does not have enough low-income housing stock to satisfy the national demand for affordable housing. In fact, the recent downturn in the economy may have created a more pressing need for low-income housing than ever before. According to Harvard University's Joint Center for Housing, the current national shortfall in low-income housing widened drastically from 2003 to 2009 and currently exceeds 6.4 million units.[6]

2.2. Debt Coverage Ratio

The term "debt coverage" relates to the relationship between net income (effective gross rental income less operating expenses and replacement reserve deposits) and mandatory debt service payments. Thus, for example, an apartment project that reports net rental income of $115,000 and $100,000 of annual mandatory debt service is considered to have a 1.15 DCR. Most lenders require housing tax credit properties to generate a debt coverage ratio of at least 1.15 before agreeing to retire a property's construction loan and extend long-term permanent financing. In addition, some lenders require higher coverage ratios for properties demonstrating lower real estate quality. The properties Reznick Group surveyed experienced a steady increase in DCR from 2008 to 2010, at a pace that was more pronounced than the trend in occupancy rates. In 2008, median DCR was 1.15, which is consistent with previous year studies based on various industry sources[7] and coincides with the current underwriting standard. However, somewhat counter-intuitively, the median DCR increased to 1.19 in 2009 and increased quite significantly again to 1.24 in 2010. There are many possible explanations for the growth in DCRs. The most obvious explanation is that the inventory of surveyed properties includes a significant cohort of properties with very low levels of debt that had not been built and stabilized when earlier studies were undertaken. A full analysis of this trend is beyond the scope of this report and will be covered in Reznick Group's expanded report.

[5] Source: U.S. Census Bureau American Housing Survey. http://www.census.gov/hhes/www/housing.html.

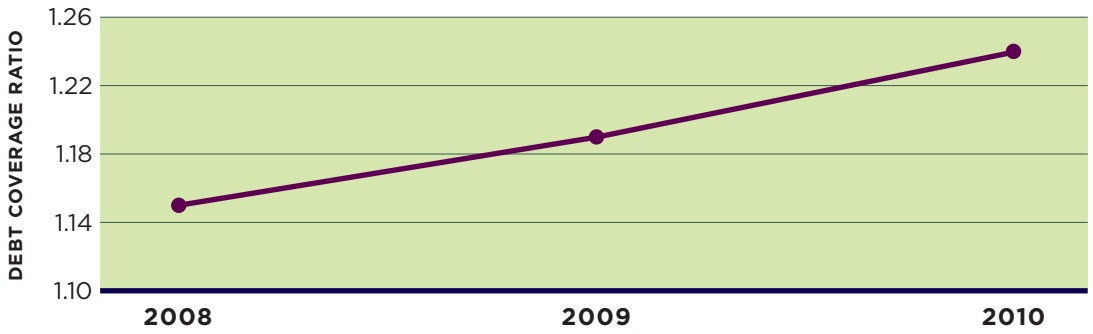
[6] Source: Joint Center for Housing Studies of Harvard University. *"The State of Nation's Housing 2011."*

[7] Source: Ernst & Young. *"Understanding the Dynamics V,"* which reports the median DCR of 12,064 housing credit properties to be 1.14 for calendar year 2006.

In addition, however, Reznick Group also attributes the growth in debt coverage in part to improved underwriting of operating expenses by state credit allocators, syndicators, lenders and equity investors and historically low interest rates.

Median Debt Coverage Ratio (2008–2010)

FIGURE 2.2



2.3. Per-Unit Cash Flow

The level of cash flow that a property generates (expressed here in terms of annual cash flow per apartment unit) closely tracks the property's DCR; however, to the extent that a property only has soft debt, DCR analysis is less meaningful. Soft debt refers to mortgage loans made by government agencies that require current payments only to the extent that the project has sufficient cash flow (or in some cases, do not require any payments until the maturity of such loans even if there is surplus cash flow). Accordingly, the number of properties reporting per-unit cash flow was larger than the number reporting positive debt coverage. In the same way that DCRs improved from 2008 to 2010, the data suggest that median cash flow per unit increased year to year from 2008 to 2010. In 2008, the median cash flow per unit was $246, which increased to $335 during 2009 and to $412 in 2010. As previously noted, while these percentage increases may appear dramatic, they represent growth in net income per apartment of less than $10 per month.

Median Per Unit Cash Flow

FIGURE 2.3

	2008	2009	2010
Median Per Unit Cash Flow	$246	$335	$412

2.4. Segmentation Analysis

An extensive, detailed analysis of the change in operating trends from 2008 to 2010 will be addressed in Reznick Group's companion report "*The Low-Income Housing Tax Credit Program at Year 25: A Current Look at Its Performance—Expanded*," with its publication forthcoming in the last quarter of 2011. Nonetheless, presented below is a high-level review of the changes in occupancy, debt coverage and cash flow by property age, investment type and other characteristics.

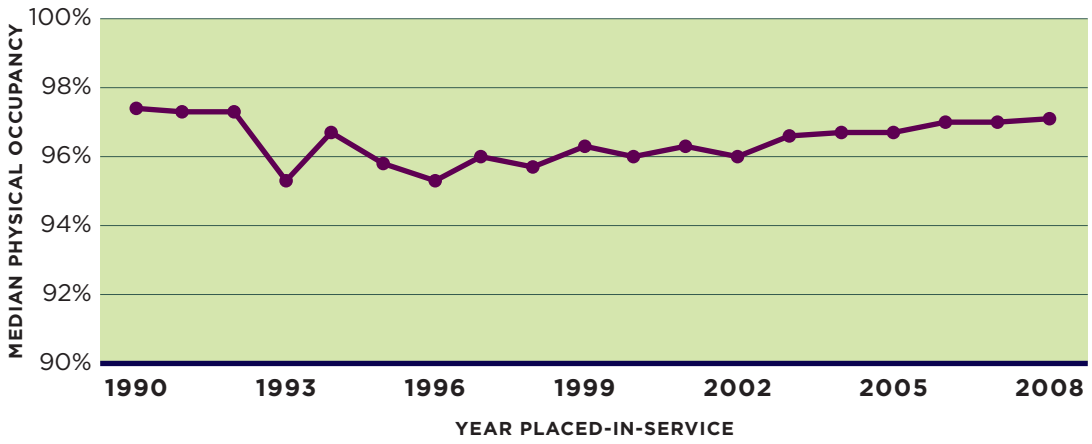
2.4.1. Segmentation Analysis — by Property Age

The following graph illustrates the operating performance data for stabilized properties and how median physical occupancy has differed based on the year in which the property was placed in service (PIS). Reznick Group chose not to present data for properties placed in service during 2009 and 2010 due to the small size of the stabilized sample during the aforementioned years. For purposes of this report, we have used "placed-in-service" date and "property age" interchangeably.

Pursuant to Figure 2.4.1(A) below, occupancy by property age is clustered within the 95.5% to 97.5% range, indicating that property age is not a material driver of occupancy rates. DCR and per-unit cash flow data display a wider spread along the age spectrum; however, Reznick Group observes that there is no linear relationship, suggesting that older properties tend to financially underperform newer ones.

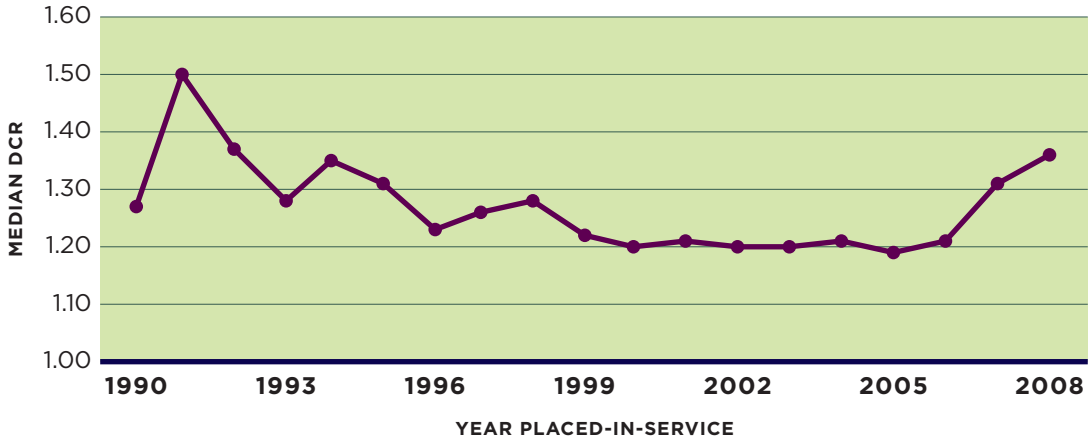
Median Physical Occupancy by Property Age

FIGURE 2.4.1(A)



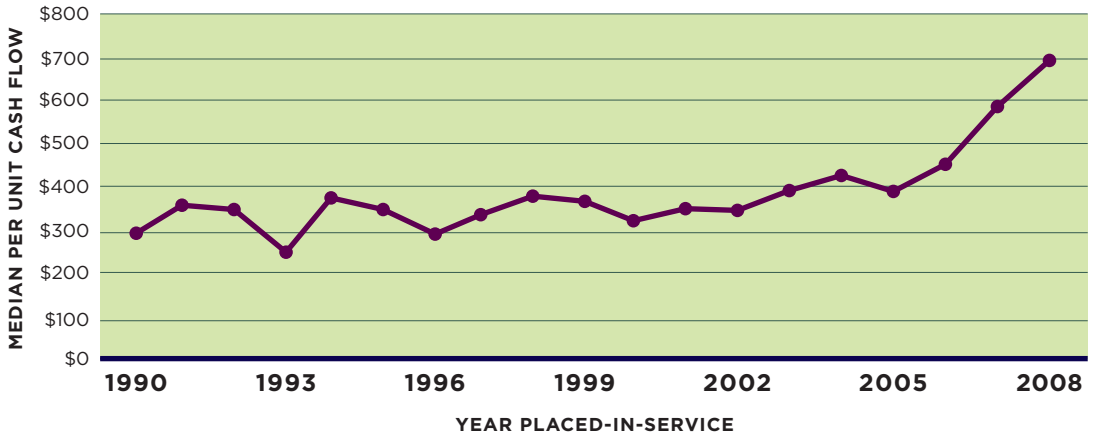
Median Debt Coverage Ratio by Property Age

FIGURE 2.4.1(B)



Median Per Unit Cash Flow by Property Age

FIGURE 2.4.1(C)



As a general matter, mature properties are expected to generate higher levels of cash flow than new properties because rental income typically grows at a slightly higher pace than operating expenses. However, this has clearly not been the case with housing tax credit properties placed in service during the past five years, as these younger properties generated above-average cash flow. As noted in Section 2.2, Reznick Group suspects that lower levels of debt financing are a significant cause of this phenomenon.

2.4.2. Segmentation Analysis — by Investment Type

Figure 2.4.2 summarizes the operating performance data for stabilized properties segmented by the source of equity financing: public funds, multi-investor funds, and so forth. As noted in Chapter 4, multi-investor fund investments account for the majority of the portfolio covered by this report. Consistent with the overall data findings, properties syndicated through multi-investor funds reported an increase in median occupancy during 2009 and 2010, at 96.3% to 96.5% respectively. For purposes of this report, Reznick Group incorporated guaranteed investments in the proprietary investment subcategory. Based on our findings, property investments held by proprietary funds slightly outperformed the overall portfolio by the single indicator of occupancy, reflecting the highest 2010 median occupancy of 96.9% among all investment types. In contrast, public funds, consisting of older property investments, reported a somewhat lower 2010 median occupancy rate of 95.8%.

Both DCR and per-unit cash flow levels for properties acquired by multi-investor funds mirrored the overall trend as well. However, with slight variations from year to year, direct investments tend to generate debt coverage and cash flow levels that are slightly lower than the overall median.

Operating Performance by Investment Type

FIGURE 2.4.2

INVESTMENT TYPE	MEDIAN PHYSICAL OCCUPANCY			MEDIAN DEBT COVERAGE RATIO			MEDIAN PER UNIT CASH FLOW		
	2008	2009	2010	2008	2009	2010	2008	2009	2010
Direct	95.6%	95.5%	96.0%	1.08	1.12	1.19	$120	$270	$371
Multi-investor	96.3%	96.4%	96.5%	1.15	1.20	1.24	$240	$340	$415
Proprietary	96.9%	96.6%	96.9%	1.16	1.19	1.24	$274	$362	$416
Public	95.8%	95.8%	95.8%	1.15	1.17	1.29	$219	$208	$334
Overall	96.4%	96.3%	96.6%	1.15	1.19	1.24	$246	$335	$412

2.4.3. Segmentation Analysis — by Credit Type

The data reflected in Figure 2.4.3 summarize the operating performance data for stabilized properties segmented by credit type. Data providers were presented with the options to classify the tax credit type for each property by 9% versus 4% housing tax credits and subsequently further separate the 9% credit properties into two sub-categories: 9% new construction properties and 4% & 9% acquisition and rehabilitation properties. However, many respondents did not represent that their properties were classified as "4% & 9%" property; thus the sample size for "4% & 9%" tax credit types was very small. For purposes of this report, Reznick Group merged the subset of acquisition/rehabilitation properties that qualify for both 4% and 9% credits into the 9% category.

As shown below, the median occupancy rate for stabilized 9% credit properties was on par with or marginally higher than 4% credit properties from 2008 to 2010. In 2010, both the 9% properties and 4% properties reported a median occupancy rate of 96.6% which is consistent with the overall portfolio median.

We have not observed meaningful differences between the operating performance of 4% versus 9% properties in terms of DCRs. However, the 4% properties we surveyed reported consistently higher levels of cash flow than their 9% counterparts. We attribute this to the fact that properties financed with tax-exempt bonds are generally larger and thus distribute their fixed costs over a wider base of apartments.

Operating Performance by Credit Type

FIGURE 2.4.3

CREDIT TYPE	MEDIAN PHYSICAL OCCUPANCY			MEDIAN DEBT COVERAGE RATIO			MEDIAN PER UNIT CASH FLOW		
	2008	2009	2010	2008	2009	2010	2008	2009	2010
4% Tax Credits	96.4%	96.3%	96.6%	1.15	1.19	1.23	$350	$432	$530
9% Tax Credits	96.5%	96.4%	96.6%	1.15	1.19	1.24	$215	$322	$387
Overall	96.4%	96.3%	96.6%	1.15	1.19	1.24	$246	$335	$412

2.4.4. Segmentation Analysis — by Development Type

Stabilized new construction properties account for the majority of the overall pool sample. As expected, based on historical results, newly constructed properties consistently reported stronger operating performance among all development types, followed by rehabilitated properties and, last, historic rehabilitation properties (i.e., properties qualifying for both housing and historic rehabilitation credits). Historic rehabilitation properties, which account for 337 properties, reported median occupancy of 95.4% in 2010, representing the lowest among all development types. Per-unit cash flow generated by historic rehabilitation properties was also substantially below average. The fact that historic buildings adapted for use as low-income housing do not perform as well as other property types should not be surprising. Historic buildings formerly used as school houses or for manufacturing are often slower to lease and, because their physical plants are less efficient, they tend to experience higher operating costs.

Operating Performance by Development Type

FIGURE 2.4.4

DEVELOPMENT TYPE	MEDIAN PHYSICAL OCCUPANCY			MEDIAN DEBT COVERAGE RATIO			MEDIAN PER UNIT CASH FLOW		
	2008	2009	2010	2008	2009	2010	2008	2009	2010
Historic Rehab	95.0%	94.7%	95.4%	1.05	1.14	1.16	$5	$129	$121
New Construction	96.7%	96.5%	96.8%	1.16	1.19	1.23	$273	$332	$414
Rehab	96.0%	96.3%	96.4%	1.15	1.21	1.27	$227	$368	$442
Mixed	96.0%	95.6%	96.1%	0.88	1.05	1.17	$(114)	$208	$290
Overall	96.4%	96.3%	96.6%	1.15	1.19	1.24	$246	$335	$412

2.4.5. Segmentation Analysis — by Tenancy Type

Based on Reznick Group's experience, housing tax credit properties set aside for senior tenants have historically reported stronger operating results than properties rented to other types of tenants. The results of our survey were consistent with that trend: seniors-only properties (21% of the total) outperformed the overall portfolio consecutively across 2008–2010 and consistently by all measures (occupancy, DCR and per-unit cash flow). These results are not surprising given that senior properties traditionally report lower turnover ratios as well as lower operating expenses as evidenced by Figure 2.4.5. However, the strong performance of properties serving tenants with special needs is not entirely intuitive. It has been our experience that special needs properties, while among the most challenging to manage, are sometimes stronger performers because they are commonly undertaken by nonprofit syndicators, many of whom have chosen to underwrite these projects conservatively and have dedicated staff managing these properties.

Operating Performance by Tenancy Type

FIGURE 2.4.5

TENANCY TYPE	MEDIAN PHYSICAL OCCUPANCY			MEDIAN DEBT COVERAGE RATIO			MEDIAN PER UNIT CASH FLOW		
	2008	2009	2010	2008	2009	2010	2008	2009	2010
Family	96.0%	95.9%	96.0%	1.13	1.16	1.21	$217	$303	$385
Senior	97.8%	97.5%	97.5%	1.20	1.26	1.30	$317	$417	$466
Special Needs	97.0%	97.0%	97.0%	1.29	1.34	1.42	$384	$505	$548
Other	96.1%	96.5%	96.8%	1.19	1.23	1.22	$102	$249	$298
Overall	96.4%	96.3%	96.6%	1.15	1.19	1.24	$246	$335	$412

CHAPTER 3

Nonperforming Properties

Given the tremendous demand and historically high occupancy rates associated with affordable housing units, Reznick Group is often asked how such projects can fail. In its effort to provide discussion points related to the failure rate of affordable housing, Reznick Group analyzed the data obtained from respondents by isolating a cohort of properties as "nonperforming" versus "performing." Nonperforming properties are those reporting physical occupancy levels below 90%, negative cash flow and other operating challenges. The properties identified as nonperforming have been further segmented to identify those that have reported operating impediments versus those that have reported technical impediments.

Operating underperformance refers to instances where a property suffers from low occupancy, operating deficits or physical plant issues such as deferred maintenance. Herein lies the similarity between housing tax credit properties and market-rate or any other real estate rental assets: Housing tax credit properties are effectively a real estate asset group unto themselves and therefore are measured, in some ways, in the same manner that their non-tax-incented counterparts are measured. However, because housing tax credit properties must conform to certain statutory requirements, they are also subject to rigorous compliance tests and layers of oversight by the IRS and state housing agencies. Because of the added burden of statutory requirements, housing credit properties bear higher administrative costs than their non-tax-incented real estate counterparts. Accordingly, a property failing to comply with housing tax credit program requirements is characterized in the report as a property that is technically underperforming.

There are limitations to Reznick Group's analysis because, like most studies before it, the focus is on stabilized properties. Thus, the report does not address construction or lease-up risks nor does it offer indicators related to properties that were unable to come to fruition because of financing feasibility issues or other development-stage challenges. The fact that some housing tax credit properties underperformed can be attributed to a number of reasons. More specifically, low occupancy can be attributed to: soft market conditions, competitive properties in close proximity to the housing credit property, ineffective tenant screening resulting in high eviction rates, and deteriorating property conditions rendering the property uninhabitable or inferior to its competition. Although this chapter explores the symptoms of underperformance of housing tax credit properties, diagnosing the underlying causes for underperformance is beyond the scope of this report because the sheer size of the portfolio renders a deeper-dive exercise infeasible.

3.1. Operating Underperformance

In addition to the static information presented, the report presents analysis related to both the duration and magnitude of underperformance. Clearly, chronic underperformance deserves more attention than pure operating volatility, as persistent underperformance results in a more likely loss on investment, while operating volatility may only result in a temporary drop in occupancy or DCR. In addition, the distribution of underperformance is an interesting indicator. For instance, assuming all other indicators remain constant, it would be natural to be concerned about a

portfolio where 35% of the properties report below 1.00 DCR with an average per-unit annual deficit of $100—in comparison to a portfolio where only 15% of the properties report below 1.00 DCR with annual deficits that are much higher. In practice however, the magnitude of operating deficits has proven to be more important than the number of properties reporting deficits.

3.1.1. Underperformance in 2010

As reflected in Figure 3.1.1, calendar year 2010 operations indicate that 9.3% (measured by net equity) of the capital invested in stabilized housing tax credit properties operated at below 90% physical occupancy, 23.8% operated at or below break-even and 25.2% incurred operating deficits. As previously noted, the incidence of properties reporting negative cash flow generally corresponds to the incidence of properties reporting debt coverage below 1.00, with the exception of properties financed exclusively with soft debt. Furthermore, while approximately 10% of housing tax credit properties operated below 90% occupancy in 2010, 25% failed to achieve break-even operations during the same period. The aforementioned spread indicates that high occupancy does not necessarily guarantee strong financial performance. While low occupancy is often a key driver of operating deficits, these deficits may be the result of a multitude of issues, including spikes in operating expenses, rent concessions and higher than normal turnover.

In our analysis of property size, Reznick Group isolated the cohort of underperforming properties as a percentage of the total number of properties (as opposed to a percentage of net equity). Comparison of the two columns in Figure 3.1.1 indicates that, as expected, properties with a higher number of units tend to withstand operating challenges more easily by distributing certain fixed costs among a larger number of units. In addition, equity investors tend to pay a premium to invest in larger projects, and premium pricing translates to lower levels of debt per apartment.

2010 Underperformance

FIGURE 3.1.1

	% OF NET EQUITY	% OF PROPERTIES
Below 90% Physical Occupancy	9.3%	12.4%
Below 1.00 DCR	23.8%	26.9%
Below $0 Per Unit Cash Flow	25.2%	28.1%

3.1.2. Historical Trend (2008–2010)

Industry observers have expressed concern about the potentially negative effect of national economic conditions on the health of housing tax credit inventory during the period from 2008 to 2010. However, the data that Reznick Group collected for 2008 to 2010 consistently suggest that this was not the case. For 2008 and 2009, the percentage of underperforming properties was largely consistent with that of pre-recession years. As such, during 2008, 11.5% of the properties

surveyed operated at below 90% occupancy, 31.1% reported below 1.00 debt coverage and 33.7% generated net operating income that was insufficient to cover their mandatory debt service payments and replacement reserve contributions. Consistent with the overall median performance data presented in Chapter 2, the number of underperforming properties decreased for two consecutive years after 2008, reaching what appears to be a historically low level in 2010.

Underperformance (2008–2010)

FIGURE 3.1.2

	% OF NET EQUITY		
	2008	2009	2010
Below 90% Physical Occupancy	11.5%	12.5%	9.3%
Below 1.00 DCR	31.1%	29.5%	23.8%
Below $0 Per Unit Cash Flow	33.7%	28.3%	25.2%

A variety of reasons may explain why housing tax credit properties fared better than their market-rate counterparts during 2008–2010:

- Demand for affordable housing, which has historically been in short supply, tends to move in the opposite direction of adverse economic conditions.
- A significant portion of the housing tax credit properties surveyed either benefit from property-based rental assistance or serve tenants who possess rental assistance vouchers. For these tenants, regardless of the gap between their ability to pay pro forma rents, tenants are responsible for contributing no more than 30% of their adjusted gross income toward rent, with some or the entire gap being covered by rental assistance. The more subsidy a property has, the more insulated it becomes from adverse economic conditions.
- Many housing tax credit properties benefit from below-market interest rates or soft financing. Properties receiving additional subsidies in the form of below-market rates or soft financing and increasingly high levels of housing credit equity permit project owners to charge rents that can be significantly below market-rate rents. While housing tax credit properties are usually underwritten with relatively small operating cushions, housing tax credit properties are clearly benefiting from lower debt burdens than their market-rate competitors and earlier generations of housing tax credit properties.

3.1.3. Chronic Underperformance

To account for the fact that housing tax credit properties, like other types of real estate, are vulnerable to operating volatility in varying degrees, Reznick Group assessed the incidence of underperformance in consecutive years. We summarized properties with less than 90% physical occupancy consecutively using three time periods: 2008–2010, 2009–2010 and 2010. Across the entire portfolio, only 6.0% of properties reported below 90% occupancy during both 2009

and 2010; and an even more modest number, 3.8% reported below 90% occupancy consecutively from 2008 to 2010. As with occupancy, properties reporting debt coverage below 1.00 and negative cash flow for sustained periods of time represent a more modest fraction of total properties than the ratio of properties reporting operating deficits for a single year. This statistic represents an important data point in terms of understanding the rare incidence of property foreclosures: The great preponderance of housing tax credit properties operate at close to break-even levels. While such properties occasionally experience negative cash flow, as shown in Figure 3.1.3, these properties tend to recover financially fairly quickly, as temporary issues are managed by their owner-operators.

Chronic Underperformance

FIGURE 3.1.3

	% OF NET EQUITY		
	2010	2010 AND 2009	2010, 2009 AND 2008
Below 90% Physical Occupancy	9.3%	6.0%	3.8%
Below 1.00 DCR	23.8%	16.7%	13.6%
Below $0 Per Unit Cash Flow	25.2%	17.4%	14.4%

Syndicators and investors commonly maintain what is referred to as a "watch list" in connection with their asset management procedures. Watch lists track assets meeting certain performance measures so that "problem" properties can be closely monitored. Watch list criteria can vary from syndicator to syndicator, so Reznick Group used the criteria established by the Affordable Housing Investors Council (AHIC)[8] as a baseline for measuring underperformance. Pursuant to AHIC standards, a property investment reporting below 90% economic occupancy or below 1.10 DCR should be placed on a watch list for close monitoring. Using the more conservative AHIC definition of underperformance, 14.8% and 33.2% respectively, of the properties we surveyed would have been placed on the watch list during 2010 by occupancy and DCR thresholds.

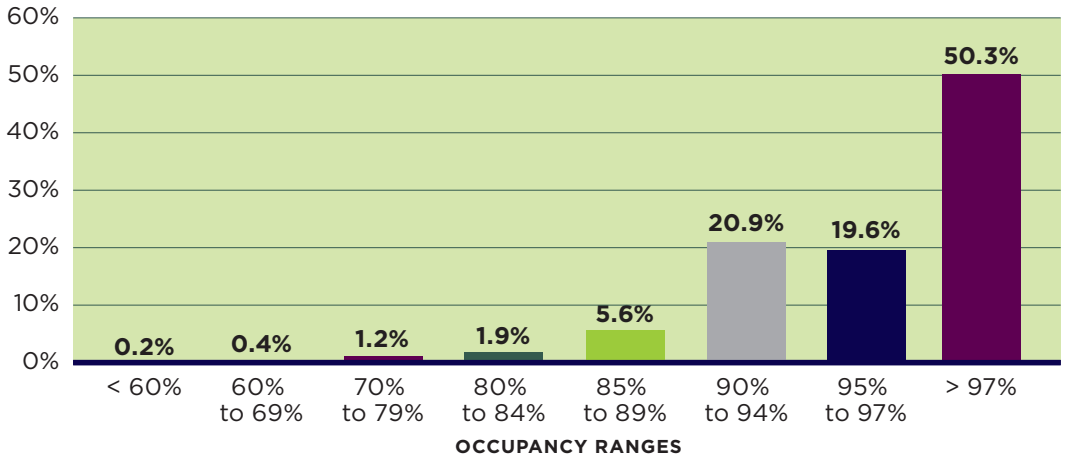
3.1.4. Magnitude of Underperformance

Reznick Group plotted the distribution of properties reporting underperformance by occupancy rate, DCR and per-unit cash flow in order to ascertain the magnitude of underperformance. Of the 9.3% properties reporting below 90% occupancy during 2010, 7.5% are clustered within the 80% to 90% range.

[8] http://www.ahic.org

Distribution of 2010 Physical Occupancy

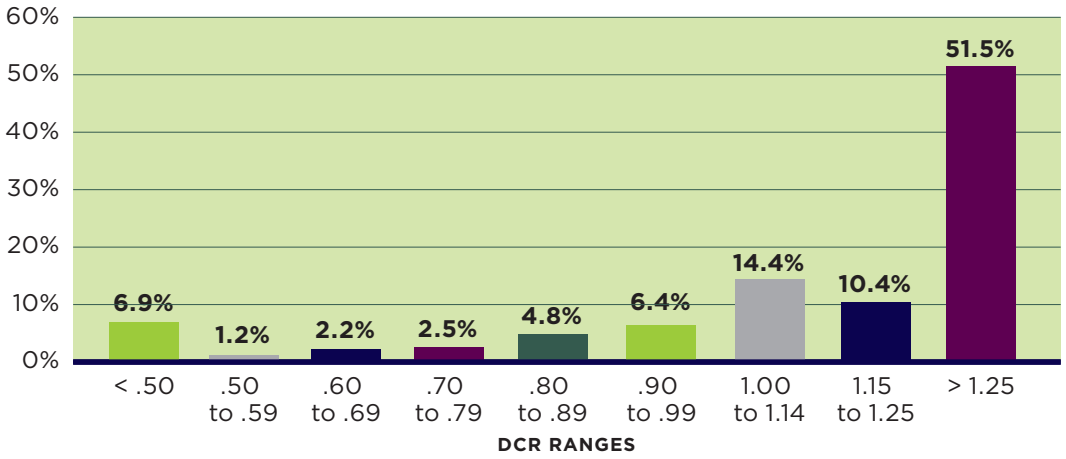
FIGURE 3.1.4(A)



A significant indicator of the magnitude of underperforming affordable housing properties is evidenced by the fact that less than 1% of housing tax credit properties placed in service have been lost to foreclosure. The low risk of foreclosure, given the fragile nature of housing tax credit property cash flows, can be understood by focusing on the relatively nominal level of negative cash flow deficits. Given the fact that only 14% of the surveyed properties report cash flow deficits that Reznick Group regards as material (i.e., more than $400 per unit), it appears that in most cases the property's developer managed deficits through a combination of withdrawal from reserves, fee deferrals, short-term suspension of replacement reserve deposits and loans to the property under guarantee obligations. On rare occasions, syndicators call upon investors to make additional capital contributions. Reznick Group expects to present further data related to the sources of operating deficit funding in the expanded report to be released in the fourth quarter of 2011.

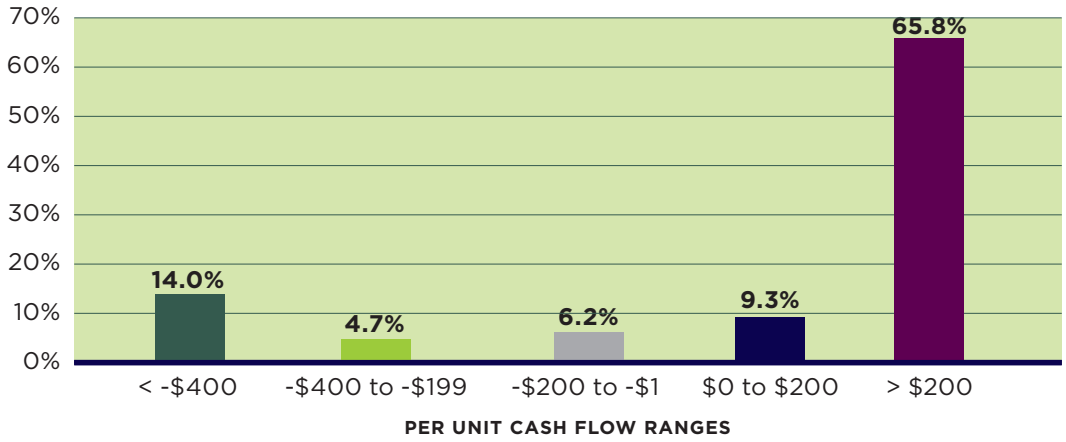
Distribution of 2010 Debt Coverage Ratio

FIGURE 3.1.4(B)



Distribution of 2010 Per Unit Cash Flow

FIGURE 3.1.4(C)



3.2. Technical Underperformance

The most significant investment risk for housing tax credit investors relates to foreclosure. If the owner of a qualifying housing tax credit project forfeits title to the property because of foreclosure or by tendering a deed in lieu of foreclosure, the transfer is treated as a sale of the property. As a technical matter, this transfer generates housing tax credit recapture. A recapture event prompted by foreclosure results in the loss of one-third of the housing credits previously claimed in addition to 100% of any future housing tax credits. Thus, while the foreclosure of housing tax credit properties has been rare, the potential impact to investors can be financially significant. Historically, properties lost to foreclosure reported large and sustained cash flow deficits. The incidence of chronic deficits may be attributed to low occupancy levels, poor sponsorship and defective construction, among other issues. However, in large part because of the flexibility and variability with which affordable housing investments can be financially supported or restructured, a remarkably low number of properties are foreclosed in any given year.

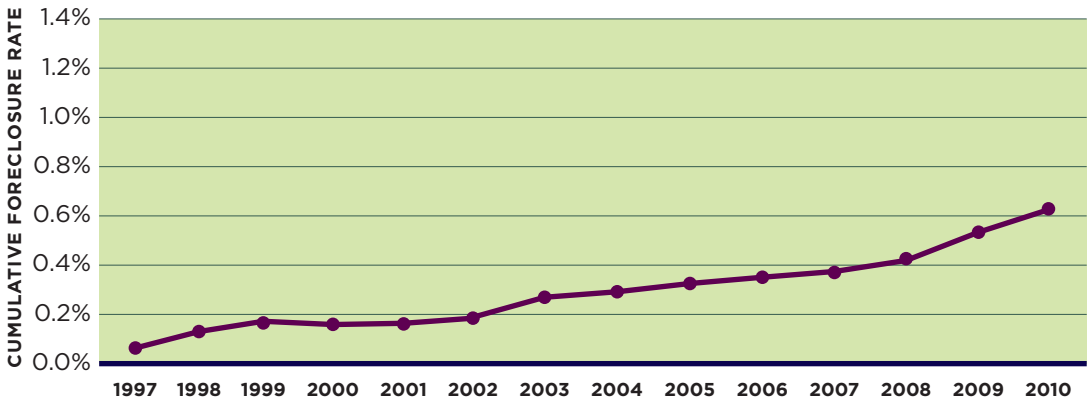
Reznick Group asked respondents to report the number of properties they lost to foreclosure, including circumstances in which a deed may have been tendered in lieu of foreclosure. Respondents reported that out of 16,399 properties (of which 15,868 were placed in service by the end of calendar year 2010) surveyed, a total of 98 properties were foreclosed and, of that number, almost half were foreclosed during the period 2008-2010. This number translates to an aggregate foreclosure rate of 0.62% calculated by number of properties. As previously noted, however, we believe the number of foreclosures may have been understated because Reznick Group was unable to obtain data it might have obtained in prior years from syndication firms that have since left the business or become inactive. As previously noted, Reznick Group has reason to believe, strictly on an anecdotal basis, that the incidence of property foreclosure has been higher among these firms than has been the case for the rest of the industry. However, since we lack precise information concerning the size and number of foreclosures in such firms' respective portfolios, any estimate we might make on the potential impact to the overall industry data would require speculation on our part. Reznick Group believes that the firms we

surveyed represent the core of the housing tax credit industry and that their care in financing and asset managing their investments is an important part of why the foreclosure rate of housing tax credit properties continues to be so low.

Reznick Group plotted the cumulative number of foreclosures on a yearly basis. The year in which foreclosures occurred was reported for 81 of the 98 foreclosed properties. To derive the yearly cumulative rate, Reznick Group divided the number of foreclosures through year end by the total number of properties placed in service on or before the corresponding year and distributed the "missing seventeen" properties evenly over the years.

Cumulative Foreclosure Rate by Year

FIGURE 3.2



While the increasing annual rate of foreclosure might be a cause for concern, the foreclosure rate must be presented in its proper context for a clear understanding of its impact:

- Reznick Group's industry experience leads us to believe that the foreclosure rate reported in the early years of the program may have been artificially low. This is due, in part, to the fact that most foreclosures occur towards the latter years of the 15-year housing tax credit compliance period. Reznick Group will present a more detailed analysis in its 2011 expanded report. The foreclosure rate in the early years of the program might have also been masked, to some degree, by the propensity of housing tax credit syndicators to support troubled properties until the end of the housing tax credit period or the point at which investor's financial losses are minimal.

- In some cases, foreclosures from 2008–2010 have had more to do with financially distressed developers than with the underlying properties in question.

- The most recent increase in the incidence of foreclosures from 2008–2010 appears to have begun to dissipate. Reznick Group notes that while corresponding information is not presented in Figure 3.2, survey respondents reported a total of five additional incidences of foreclosures from January 2011 through approximately the second quarter of 2011. The number of foreclosures in 2011, while not yet fully reported would appear to be substantially lower than the number of foreclosures in 2010.

- Finally, Reznick Group notes that at 0.62%, the rate of foreclosure in housing tax credit properties is much lower than is the case for any other real estate investment with which we are familiar.

In order for housing tax credit properties to maintain their status as qualified housing tax credit properties, they must be operated in conformity with a number of statutory provisions collectively referred to as the "compliance rules." While there are numerous provisions of Internal Revenue Code §42 that govern how the program is regulated, the most significant are the rules around tenant qualification and rent limitations. While a full explanation of the aforementioned rules is not within the scope of this report, the following provisions are significant components of IRC §42:

- In order for a prospective tenant to move into a housing tax credit property, the applicant must present written verification of household income and assets and household income cannot exceed 60% of the area median income level for similarly sized households.
- For tenants that meet the income qualification requirements, the property cannot charge rents that exceed 30% of the statutory maximum level of income.

Pursuant to IRC §42, income limits and rent restrictions must be carefully monitored by the state housing credit agencies; consequently, any failure to comply with the program rules must, if not resolved in an appropriate period of time, be reported to the Internal Revenue Service.

Survey participants reported that only 65 of the surveyed properties incurred a material level of noncompliance, yielding a nominal rate of 0.5%. However, we caution that, as is the case with the foreclosure rate analysis in Section 3.2, the rate of noncompliance may be understated because of incomplete data.

CHAPTER 4

Portfolio Composition

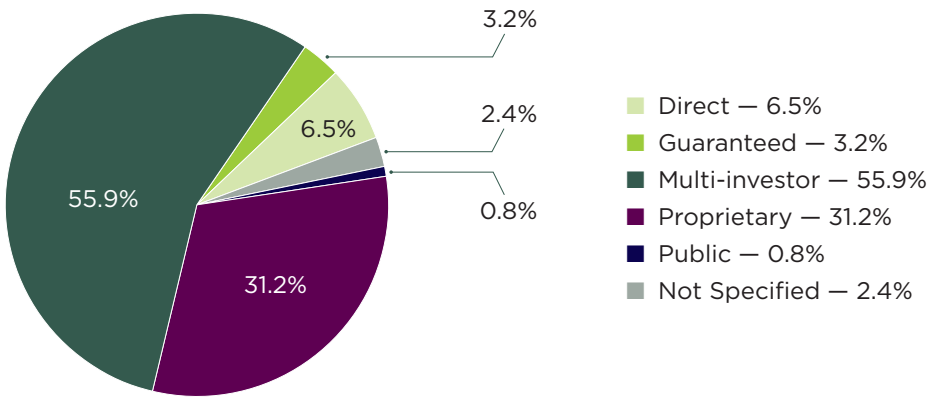
4.1. Portfolio Composition — by Investment Type

Figure 4.1 illustrates the composition of the stabilized property sample by investment type. Unless otherwise noted, percentages are presented on the basis of stabilized net equity. In the housing tax credit industry, credits have been syndicated through the sale of equity investments in public funds, direct investments, proprietary funds and multi-investor funds.

"Public funds" refers to the publicly registered offerings that were the major source of equity financing in the early years of the housing tax credit program. Beginning in the early 1990s, institutional investors began to represent the dominant share of the housing tax credit equity market making public funds increasingly rare and no longer used to raise capital for this sector. "Direct investments" refers to investments made by a single investor directly into a project partnership, as opposed to investing through a fund managed by a third party. Direct investments make up a smaller portion of the market because they require the use of internal resources to monitor real estate operations and compliance with housing tax credit program rules. Currently, most equity investments are made through third-party intermediaries or syndicators who raise investor capital, acquire equity investments in housing tax credit projects and provide long-term asset management services.

% Net Equity by Investment Type

FIGURE 4.1



Reznick Group notes that property investments made by multi-investor funds constitute the majority of the properties surveyed. Survey respondents indicated that multi-investor funds represented 55.9% of the total equity financing on a stabilized net equity basis. Proprietary fund investments account for the second highest market share, with 31.2% of net equity. In recent years, as the housing credit equity market declined sharply, investors still active in the housing tax credit market placed a disproportionate amount of their capital through proprietary funds. Reznick Group notes that this trend began to reverse in 2010 with the recovery of the equity market.

4.2. Portfolio Composition — by Credit Type

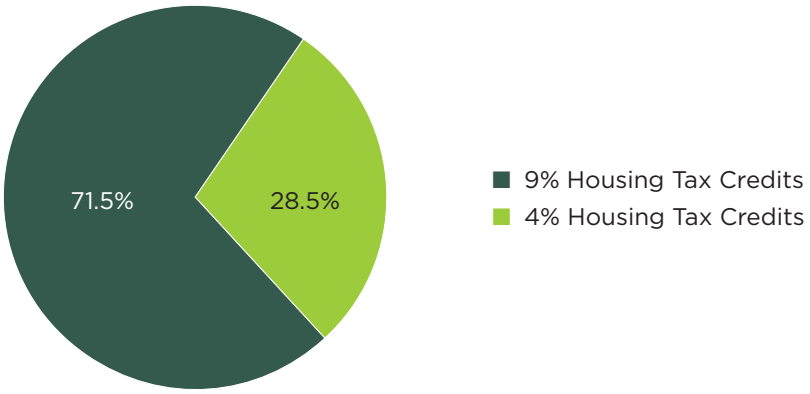
Figure 4.2 displays the inventory of housing tax credit properties surveyed and divides them into "9%" and "4%" housing credit types. Participants did not distinguish between credit types for approximately 2,000 out of the 16,634 properties surveyed. As a result, Reznick Group excluded the 2,000 unidentified properties from this analysis.

The housing tax credit statute provides for two levels of housing tax credits. Projects that are conventionally financed and are awarded housing tax credit allocations are eligible for "9% credits." An owner of a housing tax credit property may claim housing tax credits equal to 9% of the project's qualified costs each year for ten years. Conversely, properties that are financed in whole or in part by the issuance of tax-exempt bonds may claim a 4% tax credit for ten years based, again, on qualified housing expenditures. As a general matter, "9% projects" are heavily financed with investor equity and thus have a modest level of hard debt financing to service. Tax-exempt bond projects that qualify for 4% credits generate significantly lower levels of tax credit equity and require higher debt levels (albeit at lower tax-exempt interest rates).

As shown below, 9% properties account for 71.5% of the net equity surveyed, with the remaining 28.5% invested in 4% properties.

% Net Equity by Credit Type

FIGURE 4.2

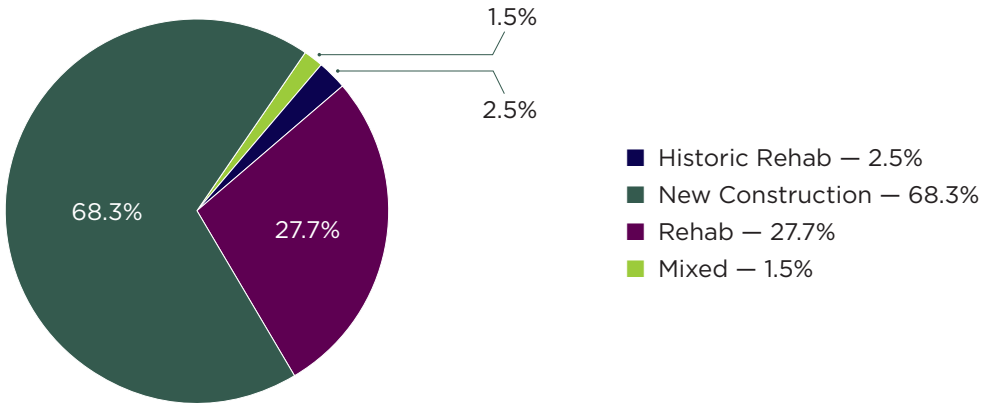


4.3. Portfolio Composition — by Development Type

Reznick Group requested that respondents specify whether their property investments represented new construction or the rehabilitation of older, existing properties. Newly constructed properties accounted for 68.3% of the net equity surveyed, and rehabilitated properties accounted for 27.7% of net equity surveyed, with the remaining 4% comprising properties that represent the rehabilitation of historic structures or properties involving mixed development types. With respect to financing, our data reflect that the average new construction development was financed with $3.7 million of net equity and the average rehabilitation property required $2.8 million of net equity.

% Net Equity by Development Type

FIGURE 4.3



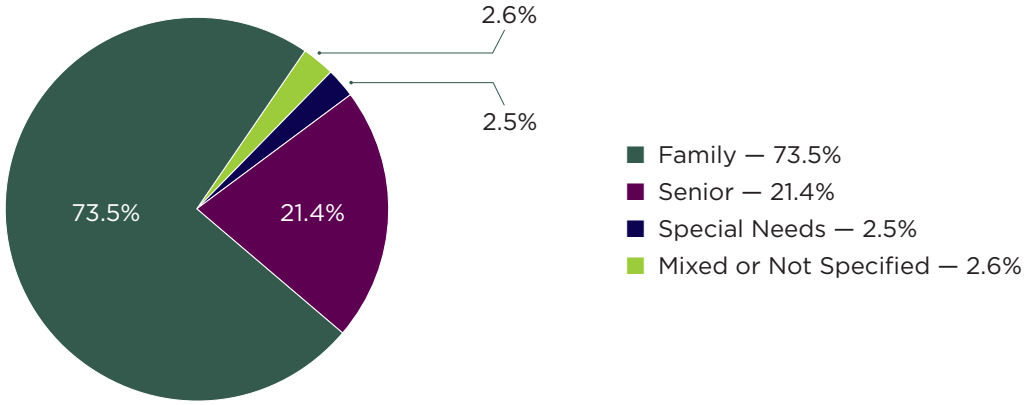
4.4. Portfolio Composition — by Tenancy Type

"Special needs" displayed in Figure 4.4 refers to properties that are set aside for unique tenancy groups. This determination is based on the state's assessment of its most critical housing needs—principally tenants with significant housing challenges, such as the homeless or tenants with physical handicaps.

The data show that family properties account for 73.5% of all properties surveyed; senior properties account for 21.4%; special needs properties account for another 2.5%; and the remaining 2.6% either have mixed tenancies or respondents did not specify tenancy type in their responses. The data suggested that there has been no meaningful variance in terms of investment size among the various tenancy types.

% Net Equity by Tenancy Type

FIGURE 4.4



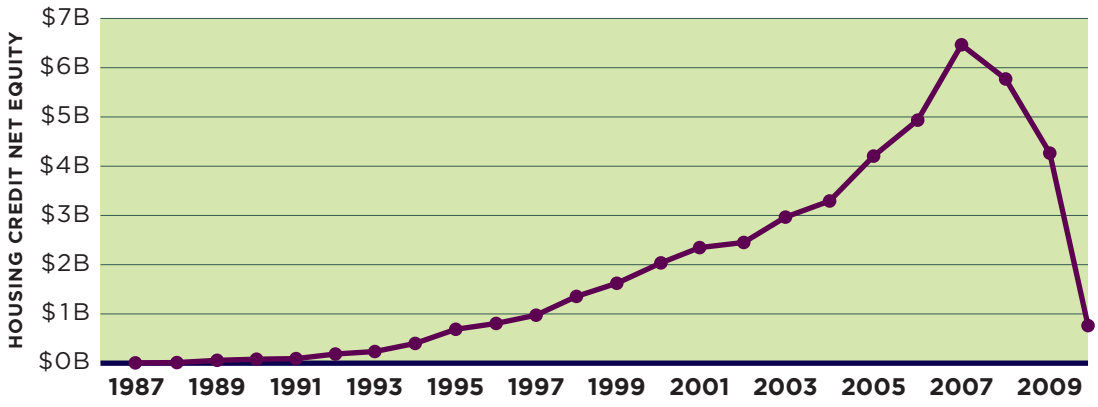
4.5. Portfolio Composition — by Property Age

The number of years that have transpired since a housing tax credit property was first placed in service is meaningful from an operating perspective. Older properties often have physical plant issues or face market competition from more recently developed properties. The composition of the housing tax credit properties surveyed is heavily weighted (48%) toward properties placed in service within the past five years. This is a reflection in part on the program's slow initial take-up rate and the fact that, with exceptions in select years, 100% of the authorized national housing tax credit allocation has been used.

Figure 4.5 displays the amount of net equity according to the year that the corresponding property investments in the survey sample were placed in service. Figure 4.5.1 displays the amount of gross equity raised by the housing tax credit syndication industry by year, based on data collected by Reznick Group from various sources.

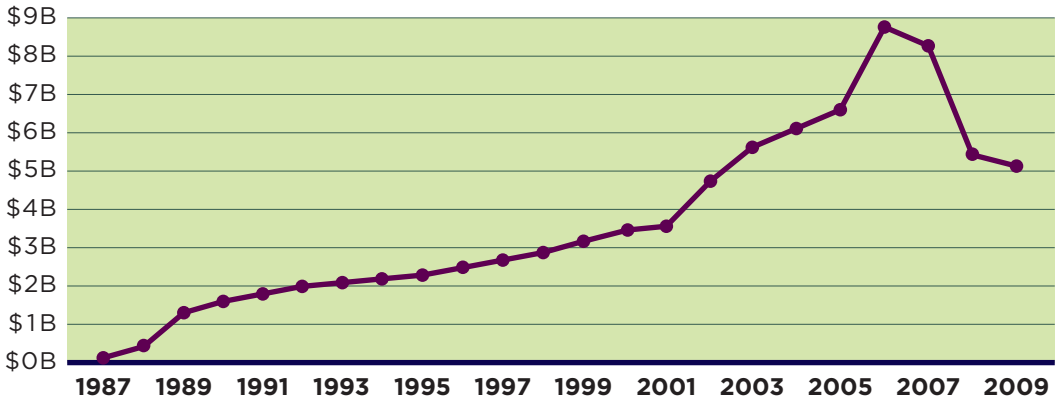
Net Equity by Year Placed-in-Service

FIGURE 4.5



Historical Overall Gross Equity

FIGURE 4.5.1

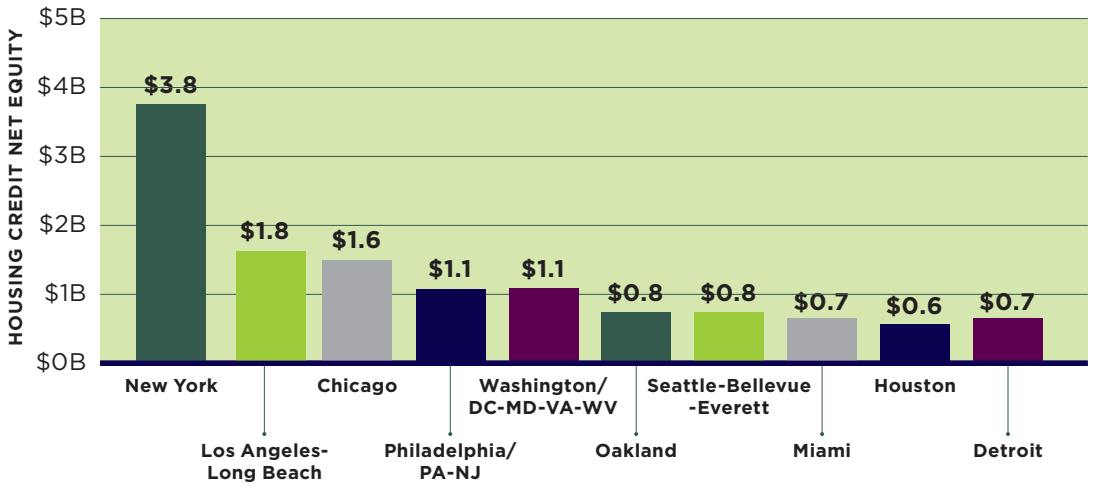


4.6. Portfolio Composition — by Top Ten MSAs

The question has been raised from time to time as to whether a disproportionate level of housing tax credits are being allocated to the nation's largest cities. Figure 4.6 illustrates the capital concentration data for properties located in the top ten metropolitan statistical areas (MSAs). As shown below, 27.8% of the total housing tax credit equity we surveyed was concentrated in properties located within the ten MSAs. Reznick Group notes that the percentage of total housing tax credit equity closely correlates to the aggregate population of residents in the ten MSAs versus the rest of the United States population.

Net Equity Concentration by Top 10 Metropolitan Statistical Areas

FIGURE 4.6



APPENDIX A

Acknowledgment

Reznick Group would like to thank the following 32 organizations for contributing data and financial support for the study:

- Alliant Capital
- Bank of America
- Boston Capital
- Boston Financial Investment Management
- Centerline Capital Group
- Citibank
- City Real Estate Advisors
- Community Affordable Housing Equity Corporation
- Enterprise Community Investment
- First Sterling
- Great Lakes Capital Fund
- Housing Vermont
- Hunt Capital Partners
- Hudson Housing
- J.P. Morgan Chase
- Michel Associates, Ltd.
- Midwest Housing Equity Group, Inc.
- National Development Council
- National Equity Fund
- Ohio Capital Corporation for Housing
- PNC Multifamily Capital
- Raymond James
- Red Capital
- RBC Capital Markets
- Redstone
- The Richman Group Affordable Housing Corporation
- Stratford Capital
- The Summit Group
- SunTrust Community Development Corporation
- Union Bank of California
- U.S. Bank
- WNC Associates

* Reznick Group also would like to thank the National Association of State and Local Equity Funds for making a financial contribution on behalf of its member organizations.

APPENDIX B

Survey Methodology

The following methodology was followed in Reznick Group's first property performance report concerning the Low Income Housing Tax Credit industry. Data for the report were developed and analyzed with the support of Integratec, Reznick Group's affiliated real estate services and software solutions company.

Reznick Group transmitted data requests to 40 active housing credit syndicators and investors. Thirty-two organizations (respondents) chose to participate in the study, representing an 80% response rate. As previously noted, Reznick Group believes that 16,356 properties, the sample size represented, is in excess of 65% of the housing tax credit properties placed in service since 1986 and provides a statistically meaningful basis for our analysis and findings.

Investor respondents were asked to provide data limited to direct investments and fund-level performance, to account for what would otherwise be a large overlap with the property data assembled from participating syndicators' portfolios. Where applicable, audited financial data were requested and were represented as having been furnished in that form. However, neither Reznick Group nor Integratec performed any independent validation of the data nor did we ascertain that the data were indeed audited. Each data element provided has been filtered to exclude certain outliers, and uploaded to a database. The database was built in a completely confidential manner to ensure that no individual data points or groups of individual data points could be attributed to any data provider.

This report represents a summary or synopsis of the data and analysis that is contained in an expanded report—"*The Low-Income Housing Tax Credit Program at Year 25: A Current Look at Its Performance—Expanded*" scheduled for release in the last quarter of 2011. A two-phase approach allows Reznick Group to supply much-needed current industry data while still operating within the timeframe necessary to perform an increasingly rigorous analysis of the data. The expanded report will include information on fund-level performance. Perhaps more important, the expanded report will provide an analysis of the impact of the so-called "Investment Test" of the Community Reinvestment Act of 1977 (CRA) on housing tax credit equity pricing. To our knowledge, an analysis of the impact of the CRA on housing tax credit equity pricing has never been undertaken at the forthcoming level of breadth and depth. Professionals active in the housing tax credit industry widely believe that there is a direct correlation between "CRA geography" and pricing. However, no organization, to the best of our knowledge, has assembled the data needed to document the existence or magnitude of such a phenomenon. Because agencies that regulate commercial banks recently began to study CRA correlation, Reznick Group believes that this is a propitious time to share the results of our analysis with industry professionals and stakeholders.

The table that follows shows the main data points requested from each participating investor and syndicator.

DATA FIELDS	DEFINITION/EXPLANATION
INVESTMENT IDENTIFICATION:	
Fund identification	Provide the name of the fund or a unique identification number from participant's database which permits future identification.
Investment type	Choose one from the following categories that best describes the investment type of the fund: direct, proprietary, multi-investor, guaranteed or public *(see glossary below)*.
Property identification	Provide the name of the property or a unique identification number from participant's database which permits future identification.
Property address	Provide the property's street address, city, state (in 2-letter abbreviation) and 5-digit zip code.
Location type	Choose one from the following categories that best describes the location characteristics of the property's location: urban, suburban or rural.
Name of MSA	Provide the name of the Metropolitan Statistical Area where the property is located.
Credit type	Choose one from the following categories: 4%, 9% or 4%/9%.
Property status	Choose one from the following categories that best describes the current status of the property: preconstruction, construction, lease-up (completed construction but hasn't achieved 100% qualified occupancy), pre-stabilization (achieved 100% qualified occupancy but not yet reached stabilization benchmarks), stabilization or disposition.
Development type	Choose one from the following categories that best describes the type of the development: new construction, rehabilitation, acquisition/rehabilitation, historic rehabilitation, or other.
Tenancy type	Choose one from the following categories that best describes the population the property has committed to serve: family, senior, special needs, family with special needs set-aside, senior with special needs set-aside, or other.

DATA FIELDS	DEFINITION/EXPLANATION
INVESTMENT IDENTIFICATION:	
Number of units	Provide the total number of housing units the property consists of.
Number of housing credit units	Provide the total number of units that are eligible for the federal low-income housing tax credits.
Project-based rental assistance	Choose whether or not the property benefits from project-based rental assistance.
Type of project-based rental assistance	If the property benefits from project-based rental assistance, choose one from the following categories that best describes the type of assistance: Section 8, Rural Development, ACC, or other. If more than one type of rental assistance program is involved, choose the primary one that covers the majority of the subsidized units.
Year placed in service	Provide the 4-digit year in which the property was or is projected to be placed in service.
First year of credit delivery	Provide the 4-dight year in which credit delivery first commenced (or is projected to commence).
Total LIHTC net equity	Provide the amount of total net equity associated with federal low-income housing tax credits and (to be) contributed to the property investment.
Total LIHTC to investor	Provide the 10-year total amount of federal low-income housing tax credits (projected to be) available to the investor limited partner.
PERFORMANCE DATA:	
Physical occupancy for years 2008 to 2010	Provide the average physical occupancy (average occupancy over the period during which the property had stabilized operations) for each of the last three years.
Debt coverage ratio for years 2008 to 2010	Provide the year-end debt coverage ratio (net operating income minus required replacement reserve contributions then divided by the mandatory debt service payments) for each of the last three years in accordance with audited financial statements. Choose "NA" if the property does not have any hard debt. For properties with partial year stabilized operations during a certain year, provide the average over the stabilized period.

DATA FIELDS	DEFINITION/EXPLANATION
PERFORMANCE DATA:	
Per-unit cash flow for years 2008 to 2010	Provide the year-end per unit cash flow (net operating income minus required replacement reserve contributions and mandatory debt service payments, if any, then divided by the total number of units) for each of the last three years in accordance with audited financial statements. For properties with partial-year stabilized operations during a certain year, provide the average over the stabilized period.
On AHIC watch list	If the watch list criteria published by the Affordable Housing Investor's Council has been adopted, indicate whether or not the property is currently on the AHIC watch list.
On internal watch list	Indicate whether or not the property is currently on participant's internal watch list.
Operating deficit funding source(s)	If the property incurred operating deficits during 2010, choose from the following funding sources (choose all that apply): investor capital call, upper-tier reserve or syndicator advance, lower-tier reserve or general partner advance, debt restructuring; and specify the primary funding source.
Foreclosure	Indicate whether or not the property has been foreclosed upon or a deed in lieu of foreclosure has been tendered.
Year of foreclosure	If the property has been foreclosed upon or a deed in lieu of foreclosure has been tendered, specify the year in which the foreclosure event occurred.
Noncompliance	Indicate whether or not the property has ever suffered from credit loss due to noncompliance issues arising from the IRS or state audit.

- Not all of the requested data fields have been included in the table above. Some requested data fields were excluded because the analysis associated with the collected data has not been presented in this report (but will be included in the 2011 expanded report).

APPENDIX C

Glossary

Credit type	There are two types of low-income housing tax credits under the Internal Revenue Code § 42: the 9% credits are available to support new construction or rehabilitation projects that are not considered federally subsidized; the 4% credits are available to support new construction or rehabilitation projects that are financed with tax-exempt bonds, or the acquisition costs of existing buildings. While the actual value varies based on a number of factors, the 9% and 4% credits are designed to subsidize 70% and 30% of the low-income unit costs in a project.
Debt coverage ratio	Net operating income (effective operating income minus operating expenses) minus required replacement reserve contributions, divided by mandatory debt service payments
Direct investment	Investors make equity investments directly into a property partnership as opposed to investing through a fund managed by a third-party intermediary.
Economic occupancy	Effective rents collected divided by gross potential rents
Foreclosure	The legal process by which a mortgagee, or other lien holder obtains, either by court order or by operation of law, a termination of a mortgagor's right to a property usually as a result of default
Guaranteed investment	Investors make equity investments to an investment fund (which, in turn, owns interest in multiple property partnerships) organized by a third-party intermediary. Under a guaranteed investment structure, the yield, as contractually agreed upon, is guaranteed by a creditworthy entity for a premium.
Metropolitan Statistical Areas (MSAs)	A geographical region with relatively high population density at its core and close economic ties throughout the area. MSAs are defined by the U.S. Office of Management and Budget, and used by the U.S. Census Bureau and other U.S. government agencies for statistical purposes.
Multi-investor investment	Multiple investors jointly make equity investments into an investment fund (which, in turn, owns interest in multiple property partnerships) organized by a third-party intermediary, and thus share investment benefits and risks.
Net equity	The amount of equity raised from "selling" housing credits to investors. Net equity is distinguished from gross equity by excluding the "load" (i.e., fees charged by syndicators for underwriting and managing the investment fund and the capital set aside for reserves).

Physical occupancy	The number of occupied units divided by the total number of rentable units in a given property
Placed-in-service	When the property is ready for its intended use, a housing credit property can either claim credits beginning the year it is placed in service (provided that units are occupied by income qualified tenants) or defer the beginning of the credit period to the following year.
Proprietary investment	A single investor makes equity investments and assumes the limited partner role in an investment fund (which, in turn, owns interest in multiple property partnerships) organized by a third-party intermediary.
Public investment	Investment funds commonly seen in the early years (pre-early 1990s) of the housing credit program when investment capital was primarily derived from individual investors
Qualified occupancy	All of the housing credit units have been leased to tenants who have been income-certified and deemed eligible to occupy such units.
Recapture	Housing credit properties are subject to a 15-year compliance period, which extends five years beyond the credit period. Credits may be recaptured during the 15-year compliance period if the property ceases to qualify as a housing credit property or ceases to be occupied by qualified tenants. The amount of recapture will be calculated based on two-thirds of the previously claimed credits plus applicable interest charges.
Soft debt	Mortgage loans where payments are subject to available cash flow
Stabilized operations	Properties that have completed construction, achieved 100% qualified occupancy and closed on permanent financing
State allocating agencies	State or local agencies that have the authority to allocate federal low-income housing tax credits to a property

About Us

About the Tax Credit Investment Services Group

The Tax Credit Investment Services (TCIS) group is a dedicated business unit within Reznick Group focused on evaluating and advising clients on tax-advantaged investments in low-income housing and renewable energy. As experts with a fairly narrow industry focus, TCIS covers a variety of consulting areas including investment due diligence, secondary market transactions and industry benchmarking research for the benefit of investor and syndicator communities.

The TCIS team is a multidisciplinary team of CPAs, lawyers, former state housing agency heads and policy and real estate experts whose advice is sought by affordable housing professionals all over the nation. TCIS is a leading provider of services to the low-income housing tax credit investor and syndication industries. In addition, TCIS teams with more than 800 fellow Reznick Group audit, tax and consulting professionals who are involved in affordable housing each and every business day.

For more information about TCIS, please visit **www.reznickgroup.com/tcis**.

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About Reznick Group

Reznick Group, P.C. is a top 20 national CPA firm providing accounting, tax and business advisory services to clients nationwide. The firm's industry experience includes affordable housing, financial services, renewable energy, nonprofits, professional services, commercial real estate and technology.

Reznick Group is:

- Registered with the Public Company Accounting Oversight Board (PCAOB)
- A member of the Center for Audit Quality and the Private Companies Practice Section of the American Institute of Certified Public Accountants (AICPA)
- A member of the AICPA Major Firms Group, which includes firms with 50 or more AICPA members (excluding the Big Four firms)
- A chartered member of the International Group of Accounting Firms Worldwide (IGAF)
- Named a "Best of the Best Firm" by Inside Public Accounting each year since 2005.

For more information about Reznick Group, please visit **www.reznickgroup.com**.