Switching Sides: How and Why Banks (Should) Make Equity Investments in LIHTC Projects

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Speakers

Thomas Curry
Partner, Banking and Financial Services, Nutter
TCurry@nutter.com

Cindy Fang
Partner, Tax Credit Investment Services Leader, CohnReznick
Cindy.Fang@CohnReznick.com

Wendy Fiscus, Moderator
Partner, Real Estate Finance, Nutter
WFiscus@nutter.com

Christopher McLoon, Moderator
Partner, Co-Leader, Affordable Housing and Community Development Practice, Nutter
CMcLoon@nutter.com

Nicholas Ratti
Principal, CohnReznick
nick.ratti@cohnreznick.com

Bryan Shumway
President, Wishrock
bshumway@wishrockgroup.com

WHO WE ARE

- CohnReznick LLP is the 11th largest public accounting firm in the U.S. with one of the largest and most experienced tax credit practices in the country.
- Tax Credit Investment Services ("TCIS") is a dedicated business unit within CohnReznick that provides strategic advisory and due diligence services to help clients make informed decisions on acquiring and managing tax-advantaged investments.
- TCIS is well-regarded in the industry for:
  - Having authored 2,000+ investment due diligence reports for tax credit investors; experienced with multi-investor, proprietary and secondary market transactions;
  - Having authored numerous affordable housing industry studies and spoken frequently at industry conferences and events;
  - Being sought after by the bank regulators and GAO to provide industry data and insights;
  - Publishing housing tax credit equity market trends on a bi-monthly basis in the *Tax Credit Advisor* magazine.

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STATE OF THE HOUSING TAX CREDIT EQUITY MARKET

HOUSING TAX CREDIT TIME MACHINE

Late 1980s
- **$1B** equity market
- **$0.40**/$1 credit
- Equity sourced from individuals

1993
- Corporate market developed
- Equity sourced from "C" corps

2000
- **$4B** equity market
- **$0.60**/$1 credit
- **10% IRR**

2006
- **$9B** equity market
- **$1.00**/$1 credit
- **4.5% IRR**

2008-2009
- Market meltdown
- Equity volume cut in half
- HERA saved the day with TCAP and Exchange programs

2010
- Market rebound

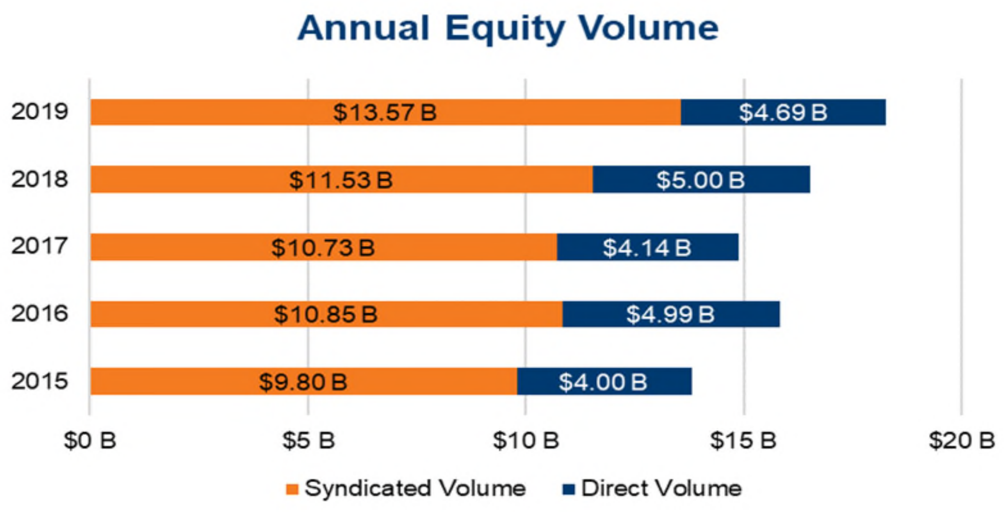
2015
- **$14B** equity market
- **$0.97**/$1 credit
- Equity sourced 85% from commercial banks (50% from top five banks)

2016
- **$16.8** equity market
- Post-election market uncertainty

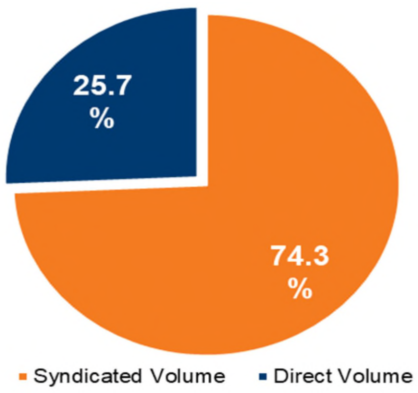
- **Post-election uncertainty**
- **Tax Cuts and Jobs Act**
- **COVID-19**

ANNUAL EQUITY VOLUME SURVEY

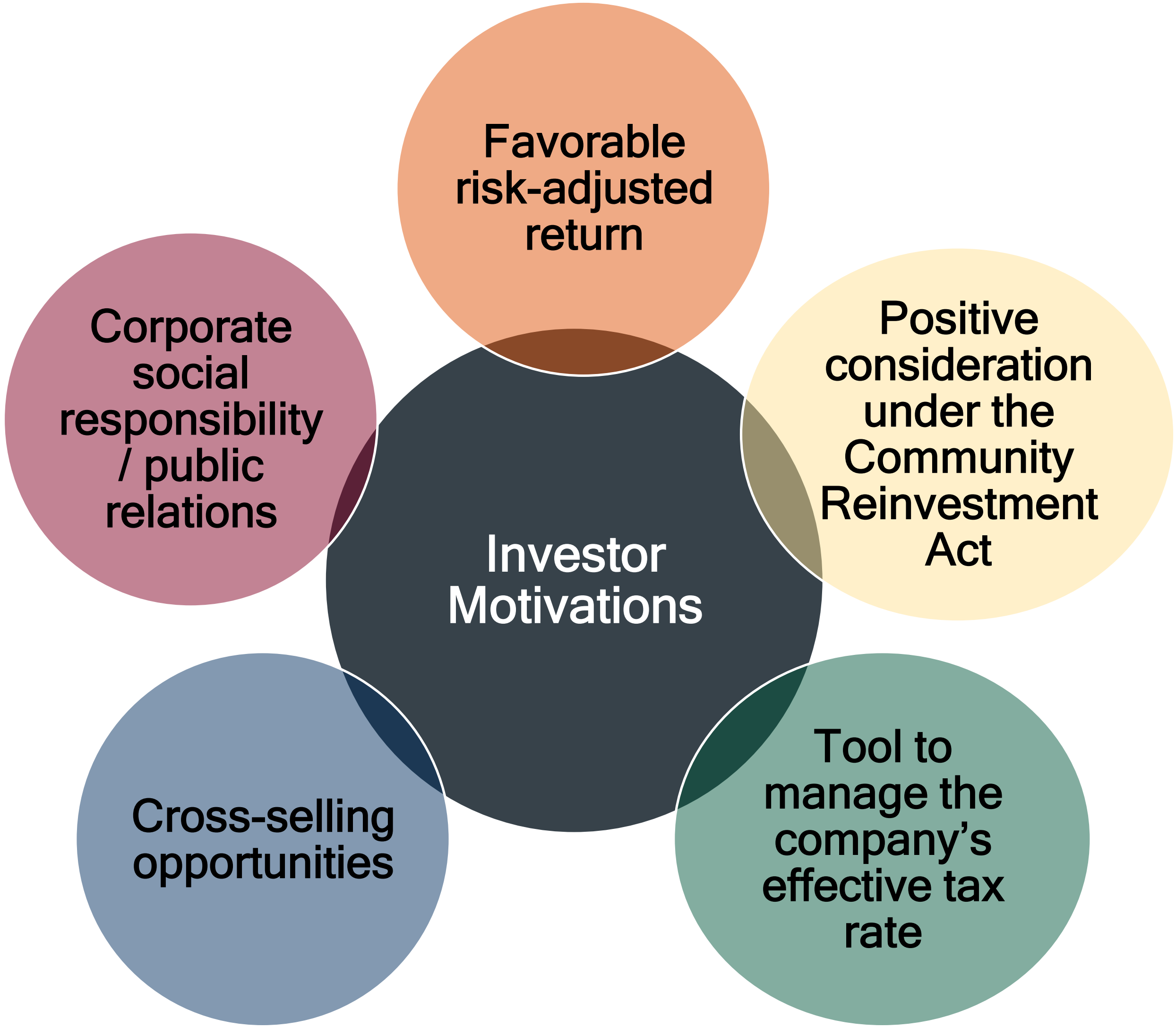
- At $18.3 billion, 2019 witnessed a new high-water mark for investor equity.



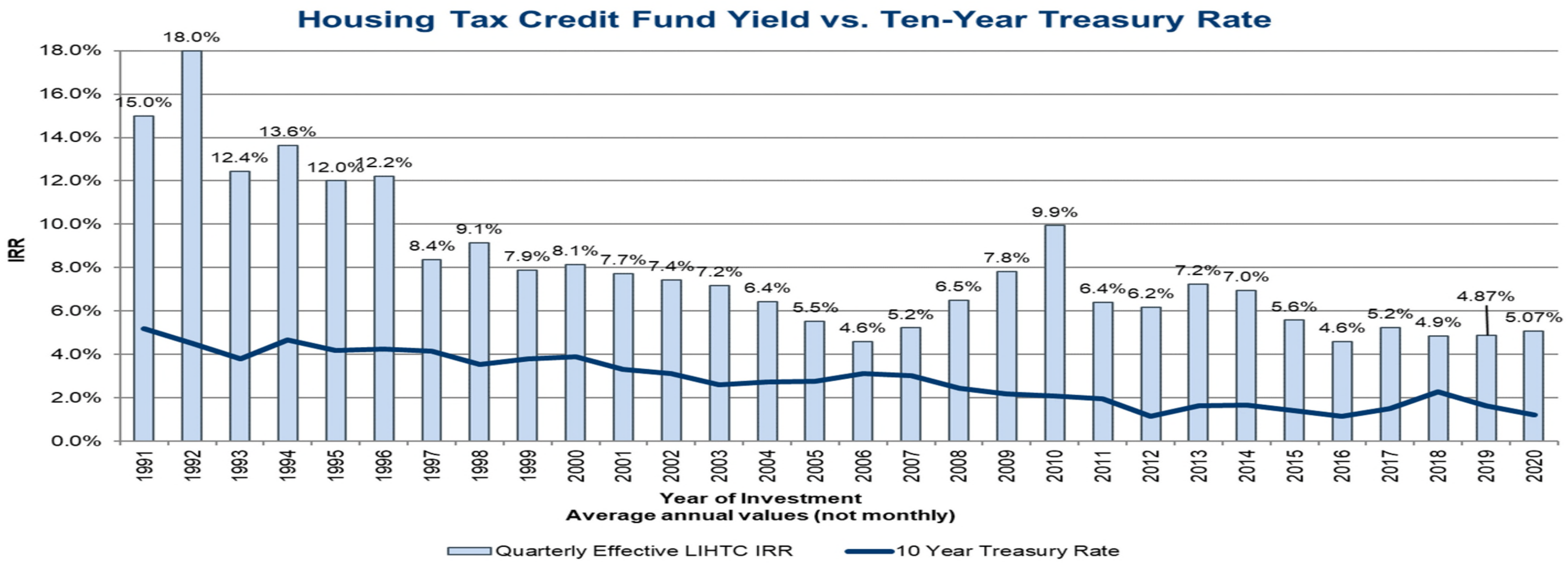
- Of the $18.3 billion total equity, 74% was syndicated and 26% was directly invested.



INVESTOR MOTIVATIONS

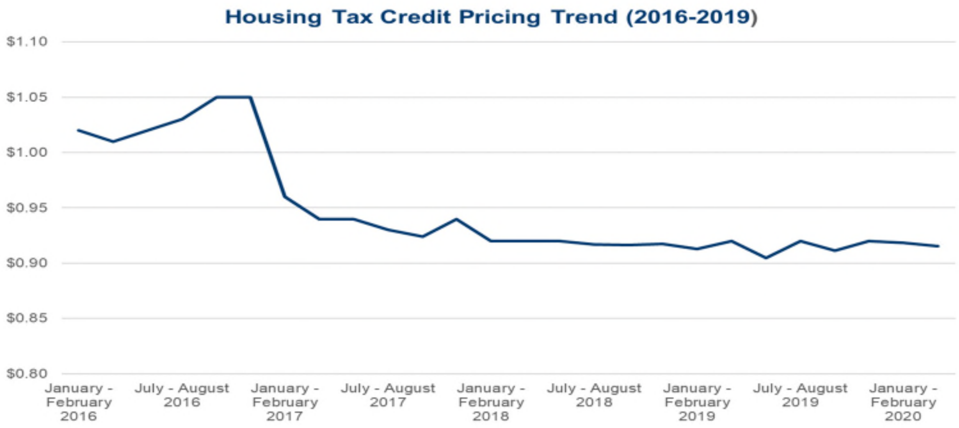


FUND YIELD VS. TREASURY RATE



CURRENT FUNDS

Syndicator / Fund Name	Estimated Fund Size (millions)	After-Tax Cash Needs IRR	Net Equity Price	Target Closing
BFIM BFIM Fund 53	$146	3.8%- 6.25%	$0.86 - $10025	October 2020
BFIM BFIM Fund 54	$120	TBD	TBD	February 2021
Boston Capital BCCTC Fund 49	$115	4.38%- 6.25%	$0.83 - $0.9725	September 2020
CREA CREA Corporate Tax Credit Fund 80	$245	3.5%- 6.4%	TBD	September 2020
Enterprise Enterprise Housing Partners XXXIV	$160	TBD	TBD	April 2021
Hunt Hunt Capital Partners Fund 41	$125	TBD	TBD	March 2021
PNC PNC LIHTC Fund 79, LLC	$160	4.5%- 6%	$0.84 - $0.99	TBD
R4 R4 Housing Partners XV LP	$190	TBD	TBD	December 2020
Raymond James RJTCF 47	$200	TBD	TBD	December 2020
RBC Community Investments RBC National Fund 31	$150	TBD	TBD	April 2021
Regions Regions Corporate Partners Fund 57	$110	4.75%- 6%	$0.88 - $0.92	April 2021
WNC WNC Institutional Tax Credit Fund 49	$153	6%- 6.4%	$0.8235 - $0.94	TBD

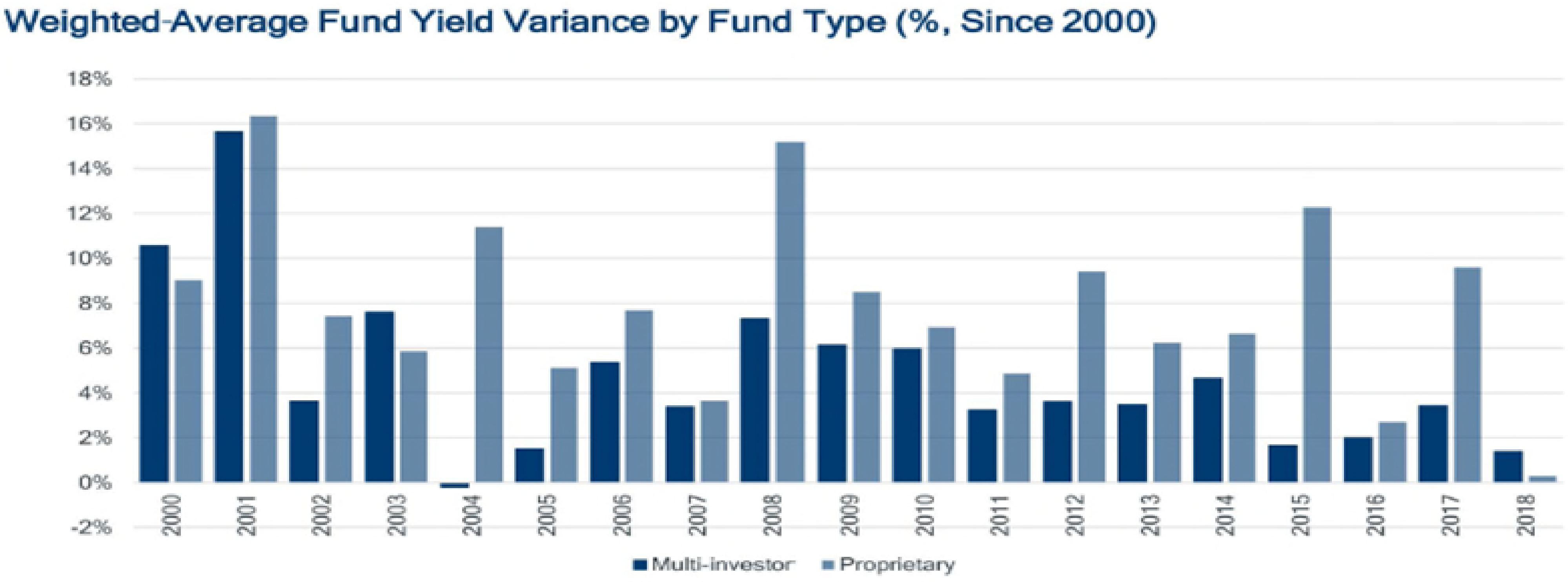


Syndicator / Fund Name	Region	Estimated Fund Size (millions)	After-Tax Cash Needs IRR	Net Equity Price	Target Closing
Cinnaire Cinnaire Fund for Housing LP 35	MI, IN, IL, WI, MN	$100	5%- 5.7%	$0.852 - $0.951	September 2020
MHEG MHEG Fund 52, LP	Midwest	$200	5.35%	TBD	October 2020
MHIC MHEF XXVI	MA	$60	4.00%	$0.94	September 2020
R4 R4 California Housing Partners VI	CA	$75	TBD	TBD	December 2020
Raymond James CAHOF IX	CA	$120	TBD	TBD	September 2020
RBC Community Investments RBC California Fund - 6	CA	$66	4%- 4.5%	$0.9 - $105	September 2020
Redstone 2020 CA Regional Fund	CA	$80	4.5%- 6%	TBD	November 2020

TRACK RECORD OF HOUSING TAX CREDIT INVESTMENTS

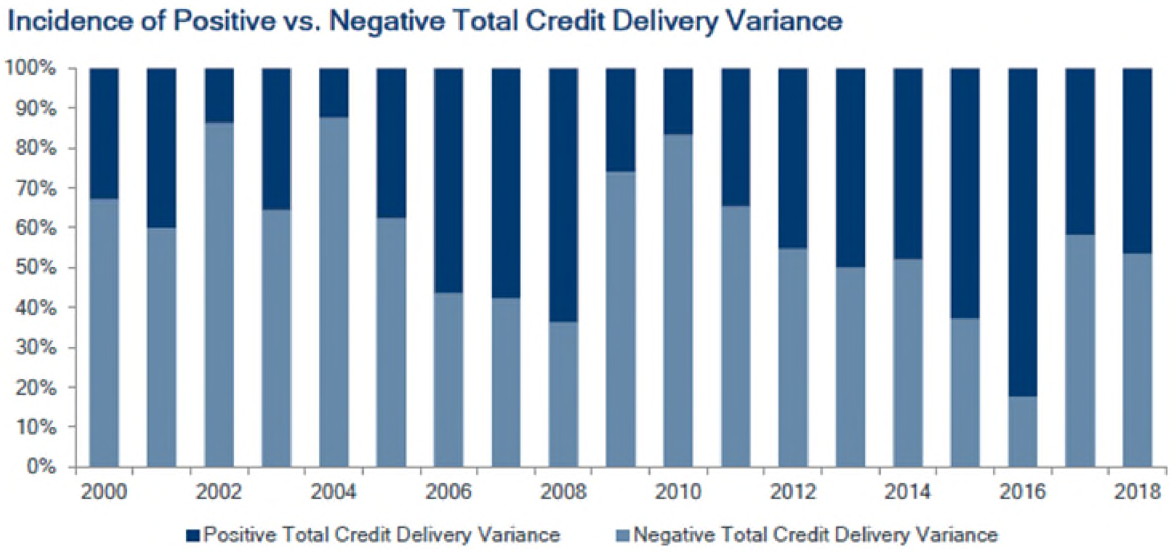
FUND YIELD DELIVERY PERFORMANCE

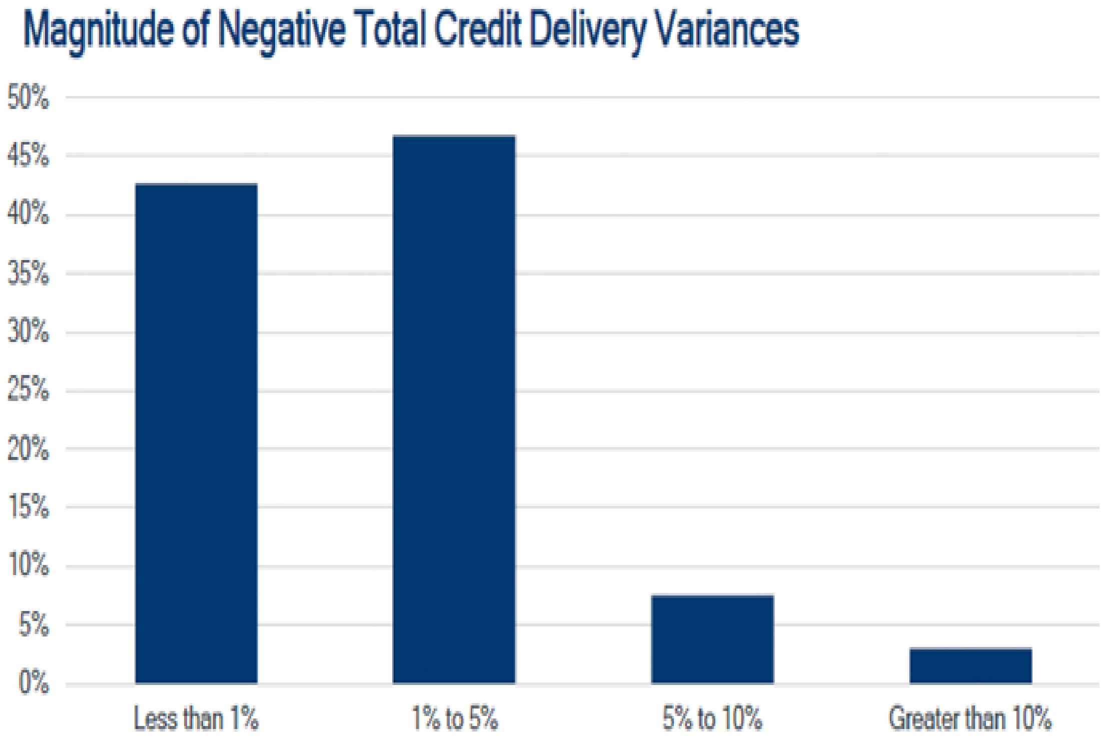
- Investors have been receiving their promised returns through housing tax credit investments.



TOTAL CREDIT DELIVERY

- Surveyed funds have delivered 99.5% of the originally projected total housing tax credits.





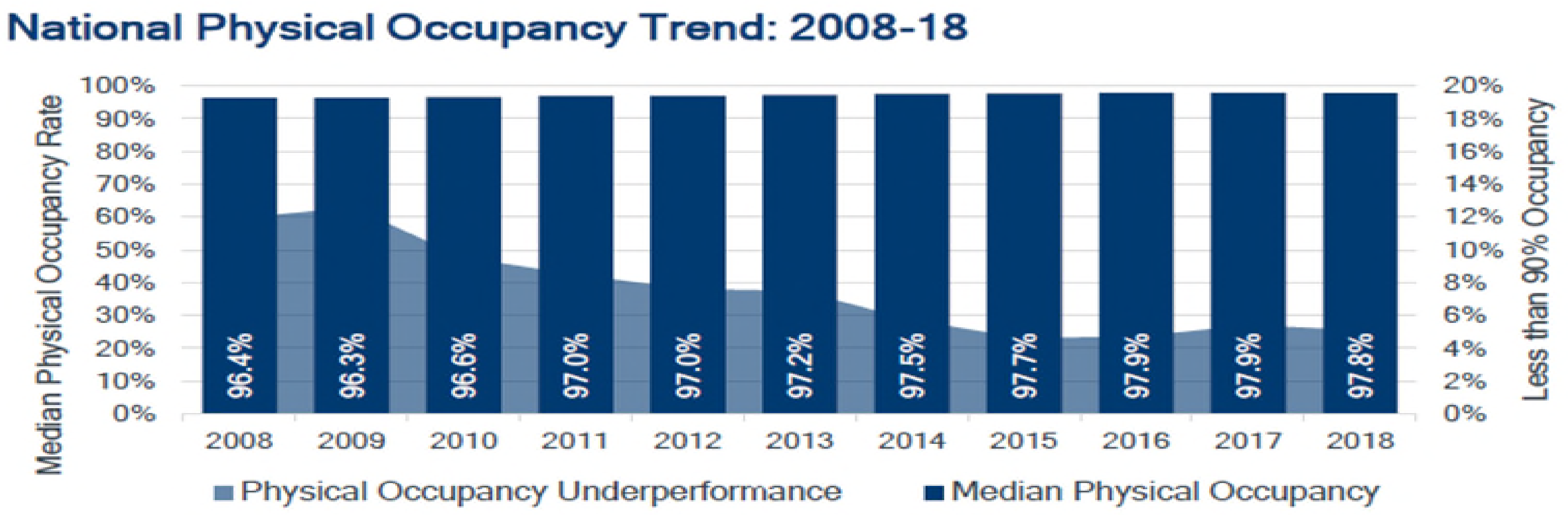
INITIAL YEAR CREDIT DELIVERY

- The industry has reduced initial credit delivery shortfalls from over (25%) to (~15%).

Initial Year Credit Delivery Variance			
	First Year	Second Year	Third Year
Credit Delivery Variance	-13.8%	-14.6%	-7.4%

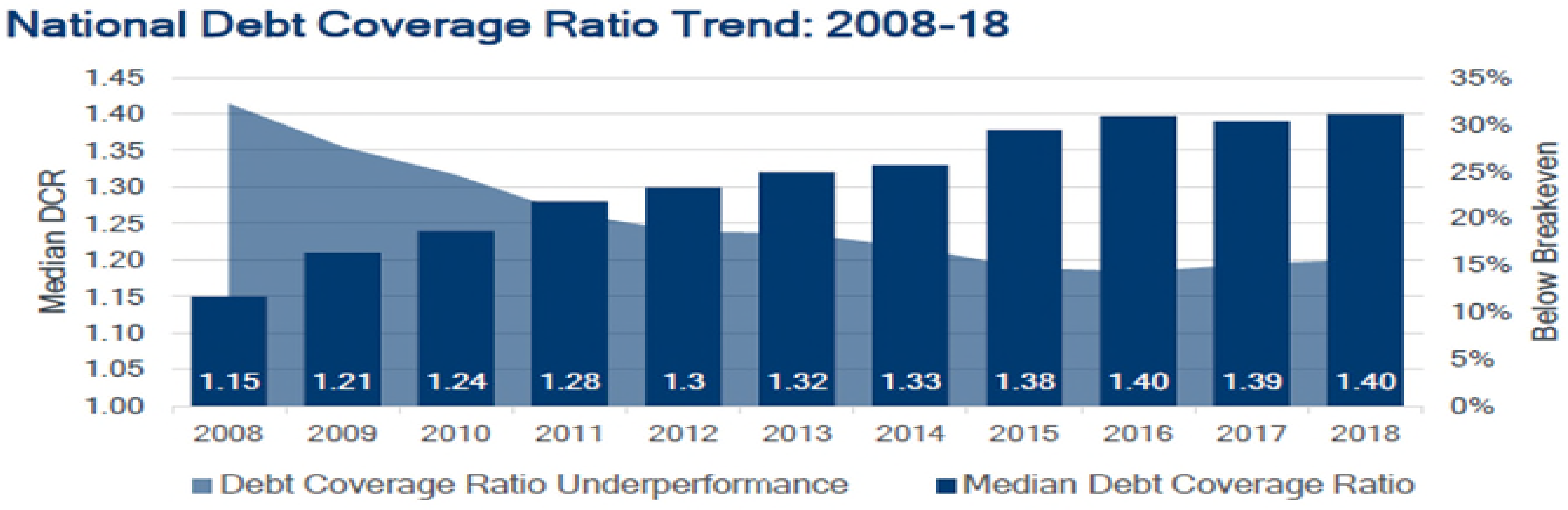
PHYSICAL OCCUPANCY

- Housing tax credit properties reported a ~98% median physical occupancy rate in 2018.



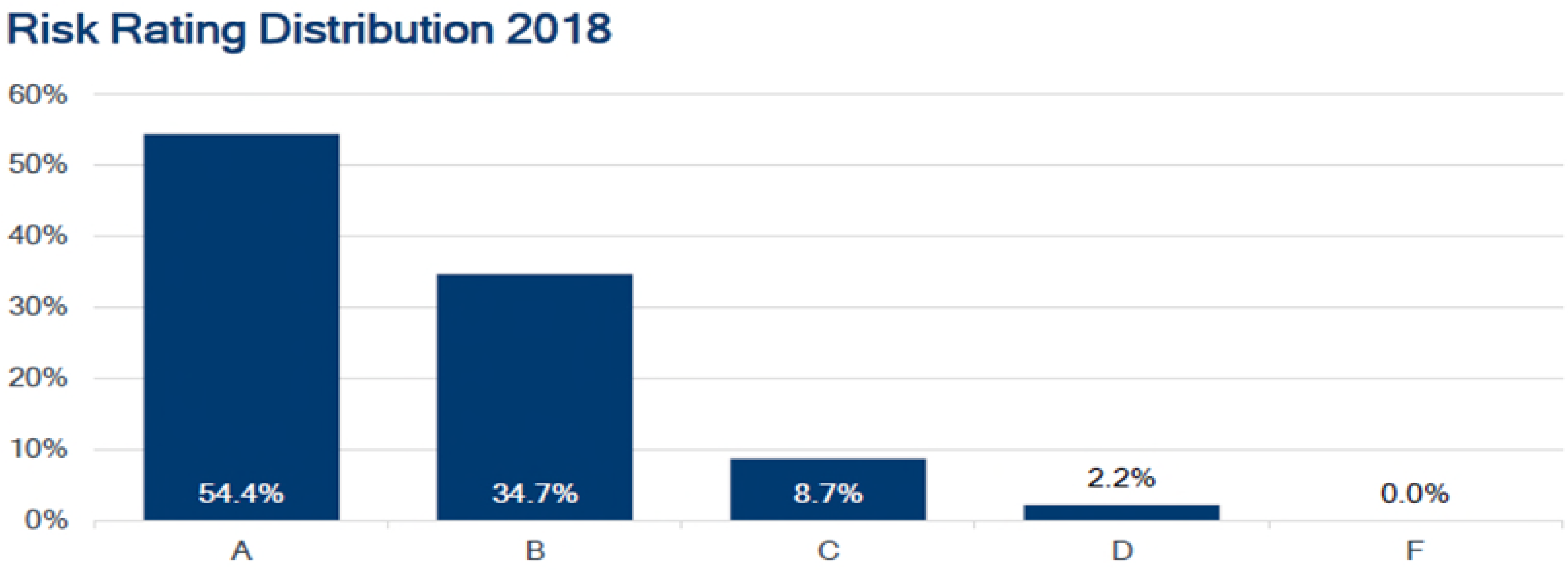
DEBT COVERAGE RATIO

- Strong financial performance trend sustained as evidenced by a 1.40 national median DCR in 2018.
- Only 16% of the national portfolio operated below breakeven in 2018, significantly declined from 32% in 2008.



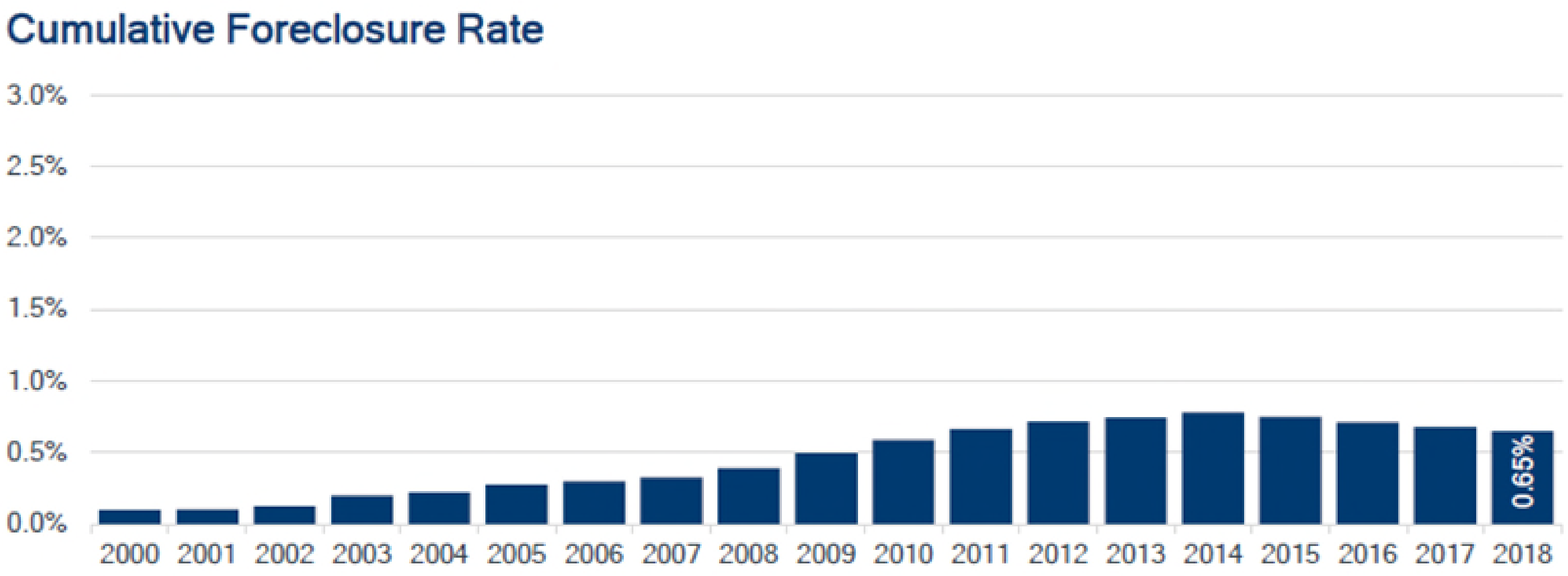
RISK RATING

- Watch list reached a historical low of under 11.0%.
- Survey respondents have adopted the risk rating criteria established by the Affordable Housing Investors Council; certain overrides existed.



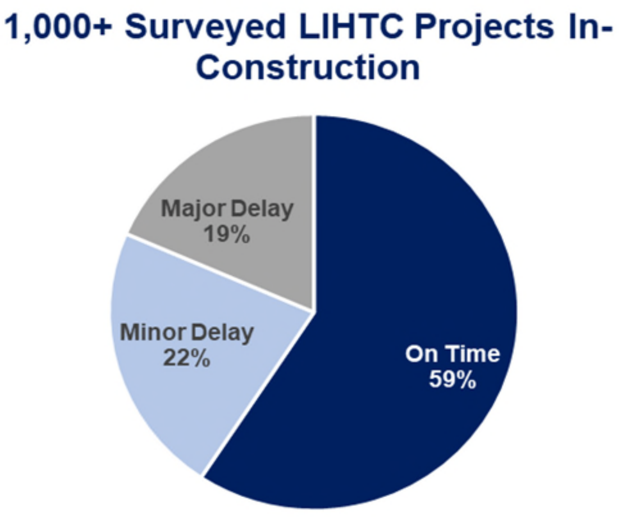
FORECLOSURE RATE

- The cumulative foreclosure rate of 0.65% ranks housing tax credit properties amongst the safest asset classes.



COVID-19 IMPACT

- Construction delays were felt but mitigates are in place.
- Rent collection remained strong through Oct 2020.
- Market has seen some modest pricing change yielding better investor return, while once again proving to be resilient.
- Long-term track record is still remarkably strong.
- Demand for affordable housing is even stronger.



Bank Regulatory Considerations

- Two primary questions:
  - Is it a permissible activity?
  - Is it eligible for positive consideration under the Federal and Massachusetts Community Reinvestment Acts (CRA)?

Permissible Activity

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- Authority depends on type of charter
- **National Banks** may make investments that are primarily designed to promote the public welfare under the investment authority in 12 USC 24 (Eleventh) and the implementing regulation, 12 CFR 24.
- Investments must primarily benefit low- and moderate-income individuals, low- and moderate-income areas, or other areas targeted by a government entity for redevelopment, or if the investments would receive consideration under 12 CFR 25.23 (the Community Reinvestment Act regulation) as a "qualified investment."
- Aggregate outstanding investments under 12 CFR 24 may not exceed 5 percent of its capital and surplus. The OCC may approve allowing a higher amount of aggregate public welfare investments up to a maximum level of 15 percent of capital and surplus, if the bank is adequately capitalized and the increase does not pose a significant risk to the deposit insurance fund.

Permissible Activity

- **Federal savings associations (FSAs)** may make public welfare under general lending and investment authorities. FSAs have the following authorities to make public welfare investments:
  - <u>De Minimis Investments - 12 CFR 160.36:</u> In the aggregate, up to the greater of 1 percent of capital or $250,000 in community development investments of the type permitted for a national bank
  - <u>Community Development-Related Equity Investments in Real Estate – Section 5(c)(3)(A) of the Home Owners Loan Act (HOLA) (12 USC 1464(c)(3)(A)), as implemented by 12 CFR 160.30:</u> Real estate must be located within a geographic area or neighborhood that is covered by HUD’s Community Development Block Grant (CDBG) program. Aggregate community development loans and equity investments may not exceed 5 percent of total assets and of that amount, aggregate equity investments may not exceed 2 percent of total assets
  - Investments in Service Corporations and Service Corporation Subsidiaries for Community Development Investments – 12 CFR 5.59 (Invest up to 3 percent of its assets in service corporations, but any amount exceeding 2 percent must serve "primarily community, inner-city, or community development purposes).
  - Other FSA Legal Authorities for Community Development Finance (If authorized under OTS legal opinions).

Permissible Activity

- **Massachusetts State-Chartered Banks:** Two-pronged analysis, Is the activity permitted under state law?
  - Authorized under the state banking code, and
  - Is a permissible activity for a national bank under Section 24 of the Federal Deposit Insurance Act.
- Public welfare type lending and investments are permitted under
  - General lending powers of G. L. c. 167E, s. 2;
  - "Leeway" investment provisions of G. L. c. 167F, s. 2(8)(i) (Aggregate investments of up to 7% of deposits; investments in excess of 3% must be in housing related entities. Loans and debt securities must be secured for term).
  - Parity with National Banks authority of G. L. c. 167, s.2 (31). (National bank public welfare investments were expressly authorized by the since repealed parity regulations 209 CMR 47.07(3)(c)2).

Federal and Massachusetts CRA Regulations

- Community Reinvestment Act Regulations are in a state of flux.
  - Two sets of federal CRA Regulations
  - Which regulations apply depends upon type of charter
  - Change in Presidential Administration may further change the CRA rules
- National Banks and FSAs
  - Subject to new OCC amended regulations
  - Small OCC community banks may elect to follow the former OCC regulations.
- Fed Member and Nonmember Banks
  - Federal Reserve released an Advance Notice of Proposed Rulemaking (ANPR) on CRA
  - FDIC and possibly OCC may join a future interagency NPR
  - Massachusetts state-chartered banks must comply with both Federal and State CRA laws, which may become inconsistent
  - Massachusetts CRA statute is G. L. c.167, s.14 and it implementing regulations are found at 209 CMR 46.00

CRA Treatment of LIHTC Projects and Funds

- CRA Regulations (1995 Version)
  - Banks may receive positive CRA consideration for community development activities related to LIHTC projects and funds, provided the activities benefit a bank's assessment area or a broader statewide or regional area that includes the bank's assessment area(s) (AA).
  - The bank's AA(s) need not receive an immediate or direct benefit from the bank's participation in the activity, provided the purpose, mandate, or function of the activity includes serving geographies or individuals located within the institution's AA(s).
  - Examiners will consider these activities even if they will not benefit the bank's AA(s), as long as the bank has been responsive to community development needs and opportunities in its AA(s).
  - Examples of activities that may be eligible for CRA consideration include direct investments in LIHTC projects, predevelopment financing or construction/permanent financing to LIHTC projects, investments in funds that specialize in funding and managing LIHTC projects, and technical assistance to nonprofit organizations that help identify and counsel potential low- or moderate-income residents.
- <u>For more information and on CRA eligibility of other tax credit programs refer to OCC Resource Directory for Public Welfare Investments.</u>

CRA Treatment of LIHTC Projects and Funds

- New OCC CRA Regulations
  - Effective October 1, 2020
  - Published list of non-exhaustive, illustrative qualifying activities. LIHTC projects and funds are expressly eligible for positive CRA consideration (See Topics H-3, I-1 and R-4).

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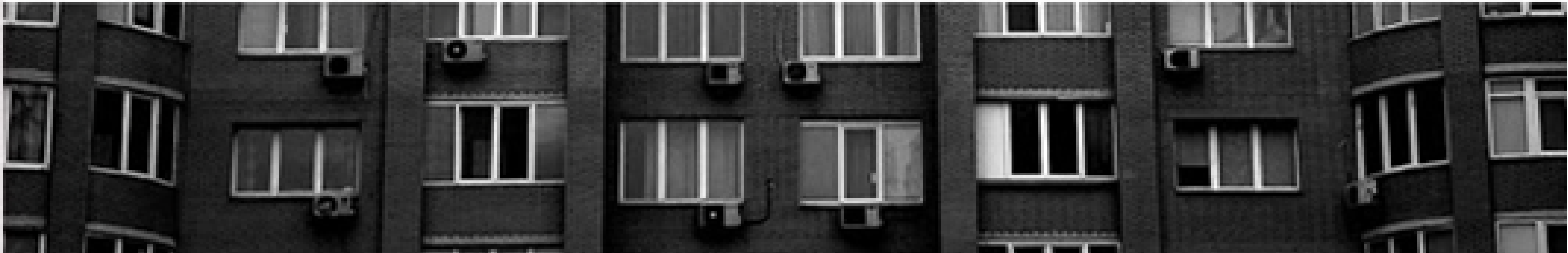
PRINCIPAL, COHNREZNICK

ECONOMIC BENEFITS & RISKS

WISHROCK

Bryan J. Shumway - President



Housing Development Process

- Site selection & Entitlement
- Market feasibility
- Financial analysis
- Architect/Contractor Planning
- Debt raising
- Equity raising
- Closing
- Building
- Lease-up
- Operation

Affordable Housing Development Process

- Site selection & entitlement
- Market feasibility
- Financial analysis
- Architect/Contractor Planning
- Debt raising
- Equity raising
- Closing
- Building
- Lease-up
- Operation

- Subsidy availability
- Stakeholder engagement

- Subsidy Application & Award
- Guarantees & Obligations
- State Agency inspections
- Cost validation

- State Agency, monitoring

Three Major Risk Mitigating Components

Subsidy Application & Award

States looking to identify:

Meet Policy Objectives
Demonstrated need for project
Experienced Development Teams
Long-term financial viability
High quality physical assets
Capacity to carry out project

Subsidy providers act as a back-up underwriting/credit committees for investors and lenders to help vet projects and improve the odds of success.

Guarantees & Obligations

Creditworthy guarantors ensure:

Completion
Loan conversion
Stabilization
Delivery of credits & compliance
Deficit-free operation

Financial risks and rewards are well allocated to ensure that those who are at risk are the ones who are in a position to manage the risk.

State Agency Monitoring

Stakeholder partners look for:

Initial obligations to be met
Compliance with IRS rules
Maintenance of physical plant

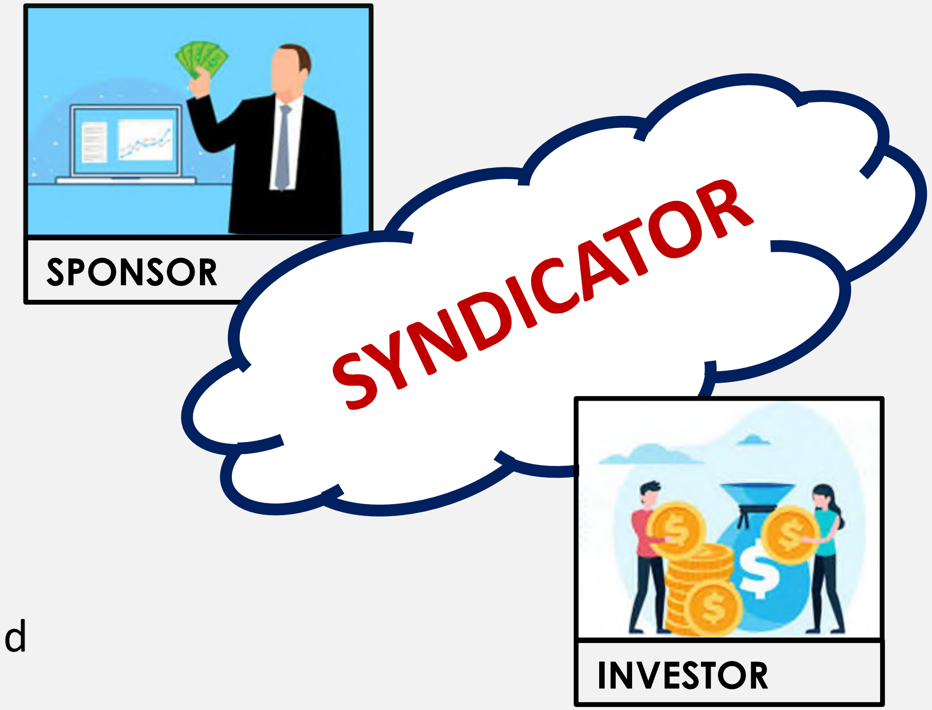
These stakeholder partners watch out for the long-term viability of the asset which, in turn, protects against the risk of loss of any credits that have been purchased.

Typical Investor Has Another Risk Mitigator

SYNDICATOR:

- Packages up multiple deals into funds to mitigate risks.
- Deep level of sponsor review; beyond that of typical Lender.
- Due diligence review for feasibility.
- Financial analysis with an eye on tax implications.
- Sometimes set-aside resources to address deal problems.

- Interface with Sponsor to manage information flow and ensure compliance.



The Final Risk Mitigant: REPUTATION

Sponsors rely on receiving awards year-after-year.

Every allocating agency asks about compliance issues in allocation process.

Allocating agencies are part of NCSHA and other trade organizations.

Syndicators and investors share info through AHIC and other trade organizations.

It is a small industry and bad actors aren't welcome:

- This impacts Lender decisions of who to work with
- This impacts Syndicator decisions of who to work with
- This impacts Agency decisions of who to fund
- This impacts Attorney and Accountant decisions of who to work with

Upcoming Webinars

What It Means To Be an American Today

A Conversation with Governor Deval Patrick

Wednesday, November 18, 2020, 12-1 PM

THANK YOU

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