June 2022

Investors Show Strong Interest in LIHTC Assets

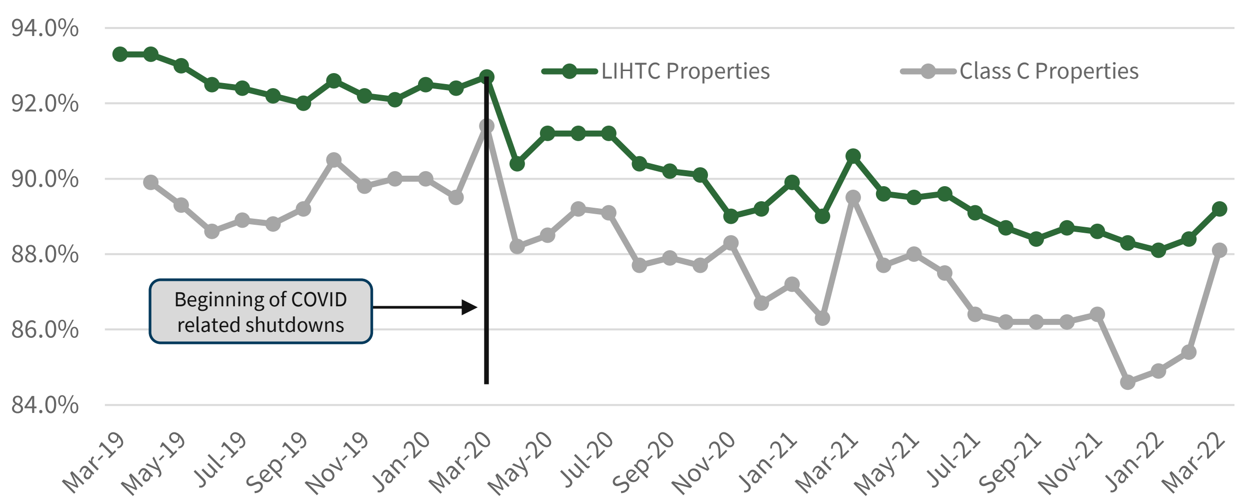
According to the 2019 American Community Survey (ACS), higher-income households occupied 28% of the non-income-restricted and non-rent-restricted multifamily rentals that were affordable to lower income households (that is, households earning 60% of the area median income (AMI) for their location). And higher-income households occupied 26% of the non-income-restricted and non-rent-restricted multifamily rentals that were affordable to households earning 80% of the AMI for their location. Those occupancies exacerbate the affordability crisis by making otherwise affordable rental units less available to lower-income households. Some of those units may also be in poor condition. In addition, lower-income renters that are lucky enough to find an affordable market-rate unit may find that it becomes quickly unaffordable. For instance, between 2020 and 2021, rents rose in some metros by almost 20% but wages did not keep pace. In contrast, apartments built or renovated under the Federal Low Income Housing Tax Credit (LIHTC) program are income restricted, rent restricted, and subject to U.S. Department of Housing and Urban Development (HUD) housing standards. Those requirements make LIHTC projects attractive to both lower-income renters looking for sustainable affordable housing and to investors looking for a quality asset with a stable renter base.

Rent Paid at LIHTC Properties

The vast majority of apartments at LIHTC properties are rented to residents earning a maximum of 60% AMI. However, maximum rent levels are set by HUD; therefore, federal stimulus payments and emergency rental assistance were able to go further at LIHTC properties during the pandemic. In addition, some of the strongest wage growth seen in recent years also helped renters at LIHTC properties pay rents more easily.

While both Class C and LIHTC properties have seen some deterioration in rents paid by month's end since the start of the pandemic, LIHTC properties have generally outperformed properties with Class C units, defined by RealPage as units in the bottom 20% of rents for a market.

Share of Rents Paid by End of Month for LIHTC vs Class C Properties



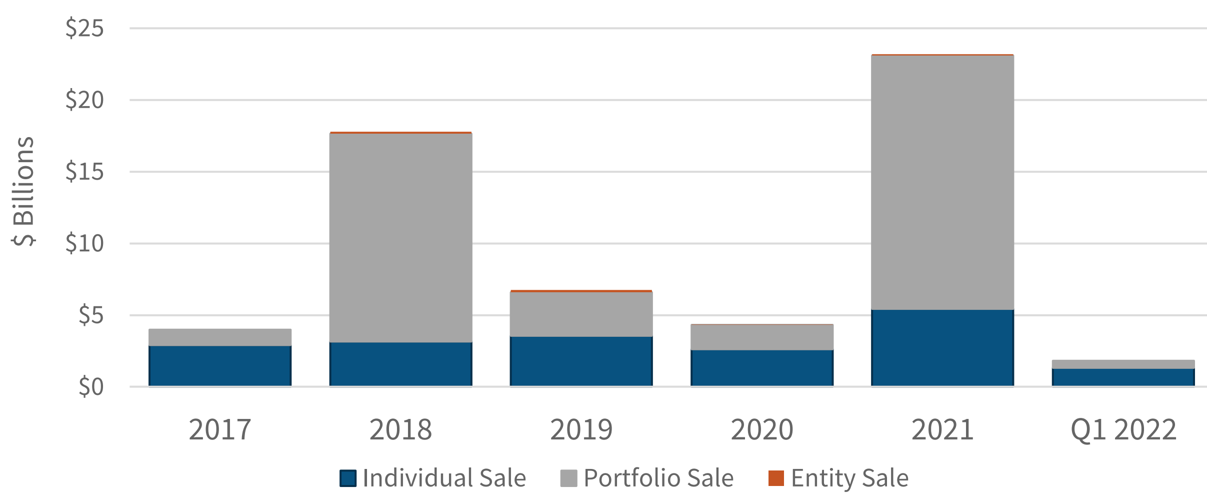
Source: RealPage, Inc. , U.S. Department of Housing and Urban Development (HUD)

Indeed, in December 2021, 88% of renters at LIHTC properties had paid their current rent by the end of the month, compared to 85% of renters at Class C properties. Since April 2019, the share of renters paying rent by month's end has been one- to three-percentage points higher at LIHTC properties than at Class C properties. This difference has not gone unnoticed by investors.

Strong Uptick in Sales in 2021

CoStar breaks out sales for different types of federally assisted properties. While not a complete record of sales, the data provides insight into trends. As shown below, sales of properties assisted with LIHTC fell during the pandemic, dropping to $4.3 billion in 2020 from $6.8 billion in 2019. However, given the stable performance of federally assisted properties during the pandemic-induced recession of 2020, some investors flocked to this asset class in 2021. In 2021, investors purchased over $23 billion of LIHTC properties, about 2.5 times the average annual sales volume recorded in the three years prior to the start of the pandemic. Further, there was growth in both sales of individual properties, which grew to $5.4 billion in 2021 from $2.6 billion in 2020, and in portfolio sales, which rose to $17.7 billion in 2021 from just $1.7 billion in 2020, largely due to purchases by Blackstone's Real Estate Investment Trust (BREIT). However, even excluding BREIT's purchases of LIHTC properties, portfolio sales grew to $7.1 billion in 2021 from $1.7 billion a year prior, indicating strong investor appetite for LIHTC properties.

LIHTC Properties Sales January 1, 2017 – March 31, 2022



Source: The CoStar Group, Inc. *Note: Includes the amount of any debt assumed as part of a deal.*

Blackstone Creates an Affordable Housing Subsidiary

A significant portion of the portfolio sales in 2021 came from Blackstone Real Estate, which recently launched an affordable housing company called April Housing. In 2021, BREIT closed on a $7.9 billion acquisition from American International Group (AIG) involving approximately 80,000 units across more than 650 LIHTC properties nationwide. In addition, CoStar recorded that BREIT paid an estimated $2.7 billion for 44 Florida LIHTC properties from Cornerstone Property, bringing about 90,000 units to April Housing. More importantly, April Housing has stated it plans to invest $500 million in the properties over the next decade.

Cap Rates Declining

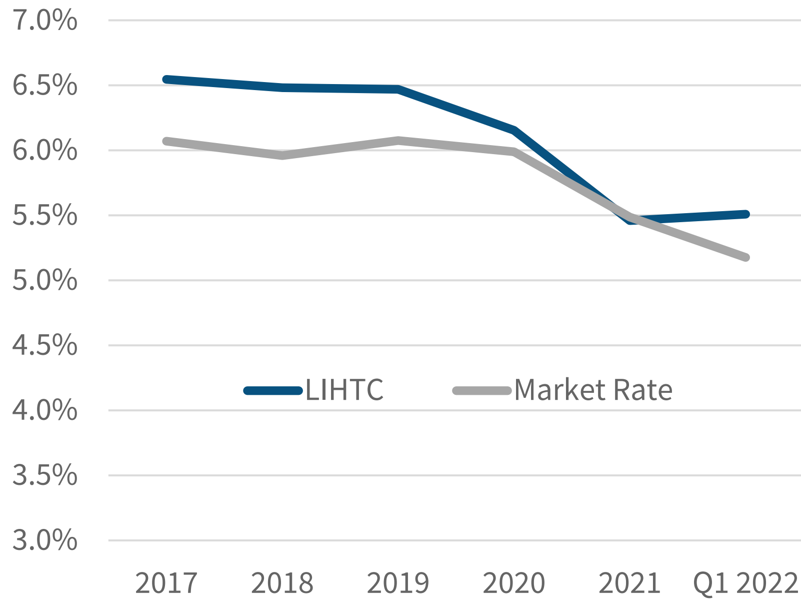
Cap rates for LIHTC properties did not appear to be impacted by the pandemic-induced recession. As shown in the chart on the right, the average cap rate at LIHTC properties has declined by 1.0% since 2019 to 5.5% as of first quarter 2022. This is consistent with increased investor interest in this asset class.

In 2019, prior to the pandemic, the average cap rate for LIHTC properties was 6.5%, just 0.5% higher than the average cap rate for market-rate multifamily properties. The pandemic brought the average cap rate for LIHTC properties even closer. As of first quarter 2022, the 5.5% average cap rate for LIHTC properties is just 0.3% higher than that of market-rate multifamily properties. This implies that investors perceive the risk of owning a LIHTC property comparable to the risk of owning a market-rate property.

Cap Rate Distribution Clustered Tightly

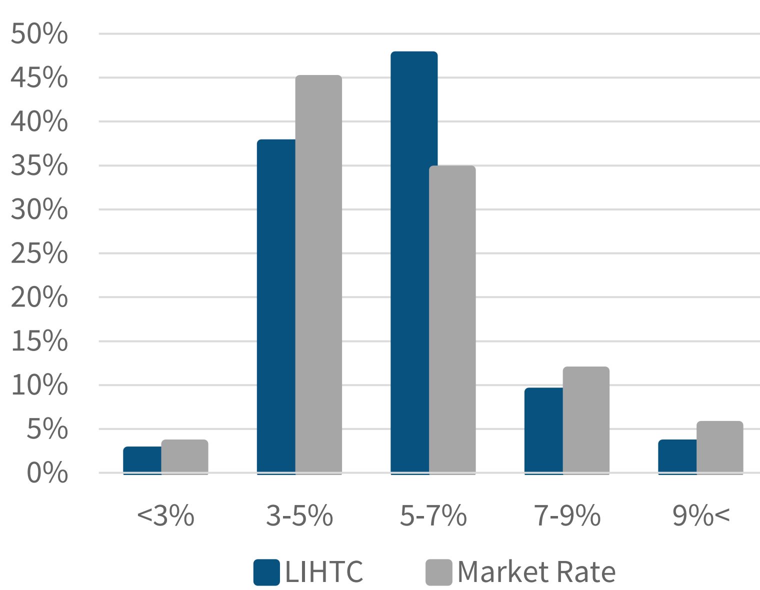
As shown in the chart on the right, cap rates for both LIHTC and market rate properties sold between January 2021 and March 2022 predominantly fall between 3.0% and 7.0%. In fact, 85% of cap rates for LIHTC properties fall between 3.0% and 7.0%, while 80% of market-rate properties fall in this range. In addition, 38% of cap rates for LIHTC properties fall between 3.0% and 5.0%. This percentage is comparable to the 45% recorded for market rate properties.

Cap Rates for Sales of LIHTC and Market Rate Properties (Actual)



Source: The CoStar Group, Inc.
Market Rate/LIHTC based on 115,000/2,400 transactions

Distribution of Cap Rates (Actual) (January 2021-March 31, 2022)

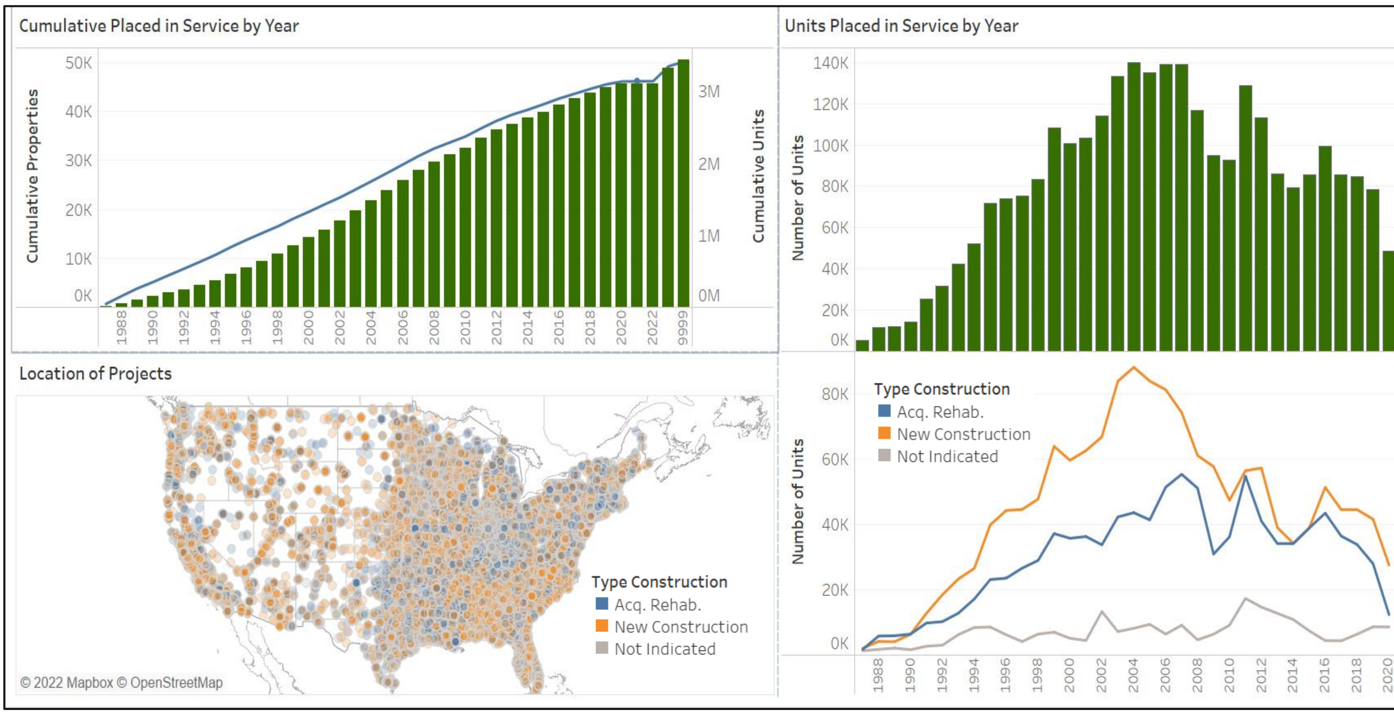


Source: The CoStar Group, Inc.
Market Rate/LIHTC based on 30,000/700 transactions

LIHTC Continues to Add Stock…

Given the ongoing affordability crisis and continued investor interest in this asset class, it is crucial for the LIHTC program to place as many new units into service as possible. As shown in the upper left chart below, an estimated 3.4 million units have been placed in service in just over 50,000 properties since the inception of the LIHTC program in 1987. According to the most recent release of the HUD LIHTC database as of April 2022, which includes units placed in service through 2020, approximately 3.0 million of these units in almost 42,000 properties remain in service.

Select Statistics for LIHTC Properties



Source: HUD LIHTC Database as of April 2022, includes LIHTC placed in service through 2020
Note: Code "9999" indicates that project has been completed but placed in service date is missing.

…But At A Slower Pace…

The number of new LIHTC units placed in service annually appears to have slowed in recent years, as shown in the upper right chart above. For instance, in the five years prior to the Great Recession, which started in December 2007, just under 137,000 units were placed in service on average annually. In contrast, after the Great Recession, from 2010 to 2019, the last year for which the HUD LIHTC database has relatively complete data, fewer than 100,000 new units were placed in service on average annually. While part of the decrease may be due to a lag in reporting, high construction costs also had a negative impact on the production of affordable units.

…as New Construction Has Declined

As shown in the lower right chart above, in 2004, approximately 88,000 units were placed in service in newly built properties, compared to about 44,000 units in properties that were rehabbed to keep units safe and appealing. However, since the end of the Great Recession in June 2009, the split between newly built properties and properties being rehabbed has been more even, with fewer than 60,000 new units built annually.

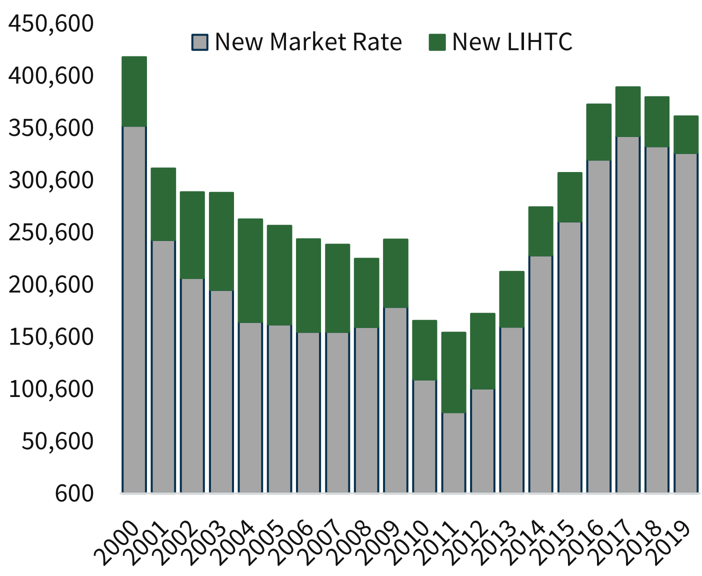
Report Confirms Increasing Costs

This downward trend is consistent with the findings of a recent Terner Center Report, *The Costs of Affordable Housing Production: Insights from California's 9% Low-Income Housing Tax Credit Program*, which showed that total development costs have risen dramatically in California since 2008. The report found that the average cost per unit of 9% LIHTC new construction increased from $411,000 to $480,000, an increase of over 17% from 2008 to 2019. The cost per square foot has grown even more dramatically, from $451 per square foot in 2008 to $700 per square foot in 2019, an increase of 55%. The report concluded that, in broad terms, the same amount of public subsidy is now needed to build two units at 1,000 square feet as was needed for three units just 10 years ago.

Affordable Share Has Not Kept Pace

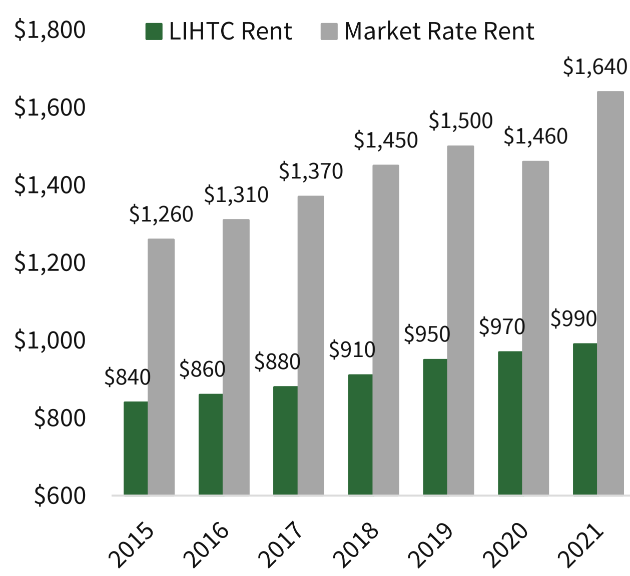
While the Terner Center study took place in California, this increase in costs appears to have played out across the country. As shown in the left chart below, as the number of units completed annually at new market-rate properties has tripled since 2012 to almost 330,000 units, the number of new units completed at LIHTC properties appears to have fallen below 60,000 annually in recent years. As a result, only about 15% of new units under construction in recent years have been affordable, compared to about a quarter of new units prior to the Great Recession.

Number of Completed Market Rate Units and New Units at LIHTC Properties



Source: Dodge Data & Analytics Supply Track, HUD LIHTC Database

Monthly Average Asking Rent for LIHTC Units vs. Market Rate Units



Source: Moody's Analytics CRE

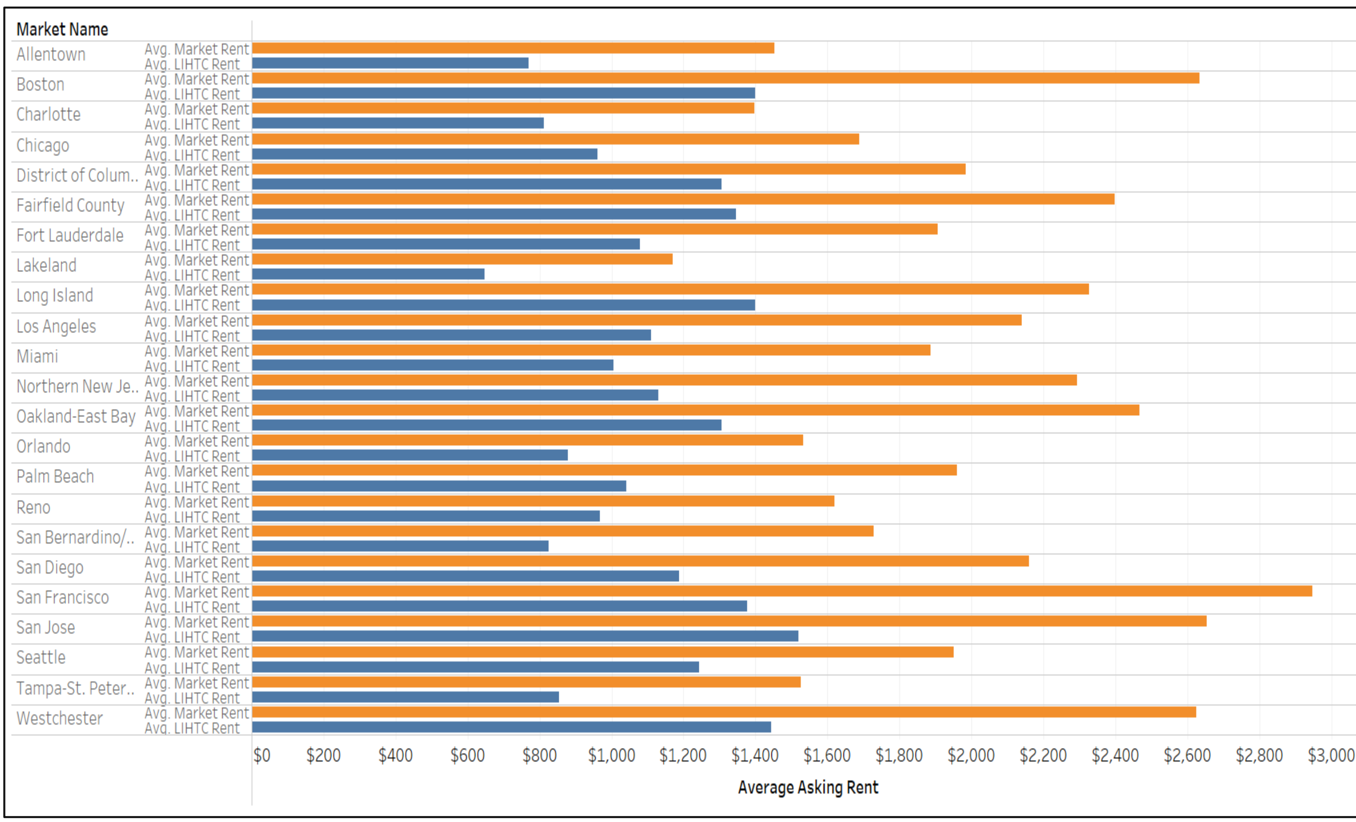
Rents Remain Affordable at LIHTC Properties

While developers have been able to increase the number of units at new market-rate properties substantially in recent years, it has come at a cost to renters. The average rent at a market-rate apartment rate has risen by 30%, almost $400, over the past six years to an estimated $1,640 in 2021, according to Moody's Analytics CRE. In contrast, the average asking rent at an affordable unit at a LIHTC property has risen by about $150 over the same time period, representing a 17% increase. LIHTC rents were at 67% of market rents in 2015 but dropped to just 60% of rents by the end of 2021. The differences are even greater at the metro level.

LIHTC Rents Substantially Lower than Market Rents in Some Metros

As might be expected, LIHTC rents are most affordable in major coastal cities. For instance, in **San Francisco, Boston** and **Northern New Jersey**, the average asking rent for LIHTC units as of fourth quarter 2021 was 53% or less of market rent. However, as rents at market-rate properties have risen sharply over the past year, more traditionally affordable markets are also seeing a significant advantage in LIHTC rents. For instance, as shown in the chart below, **Allentown, Tampa, Orlando,** and **Charlotte** all recorded rents at LIHTC apartments that are just 58% or less of market-rate rents.

LIHTC Rents vs Market Rents Select Metros as of Q4 2021

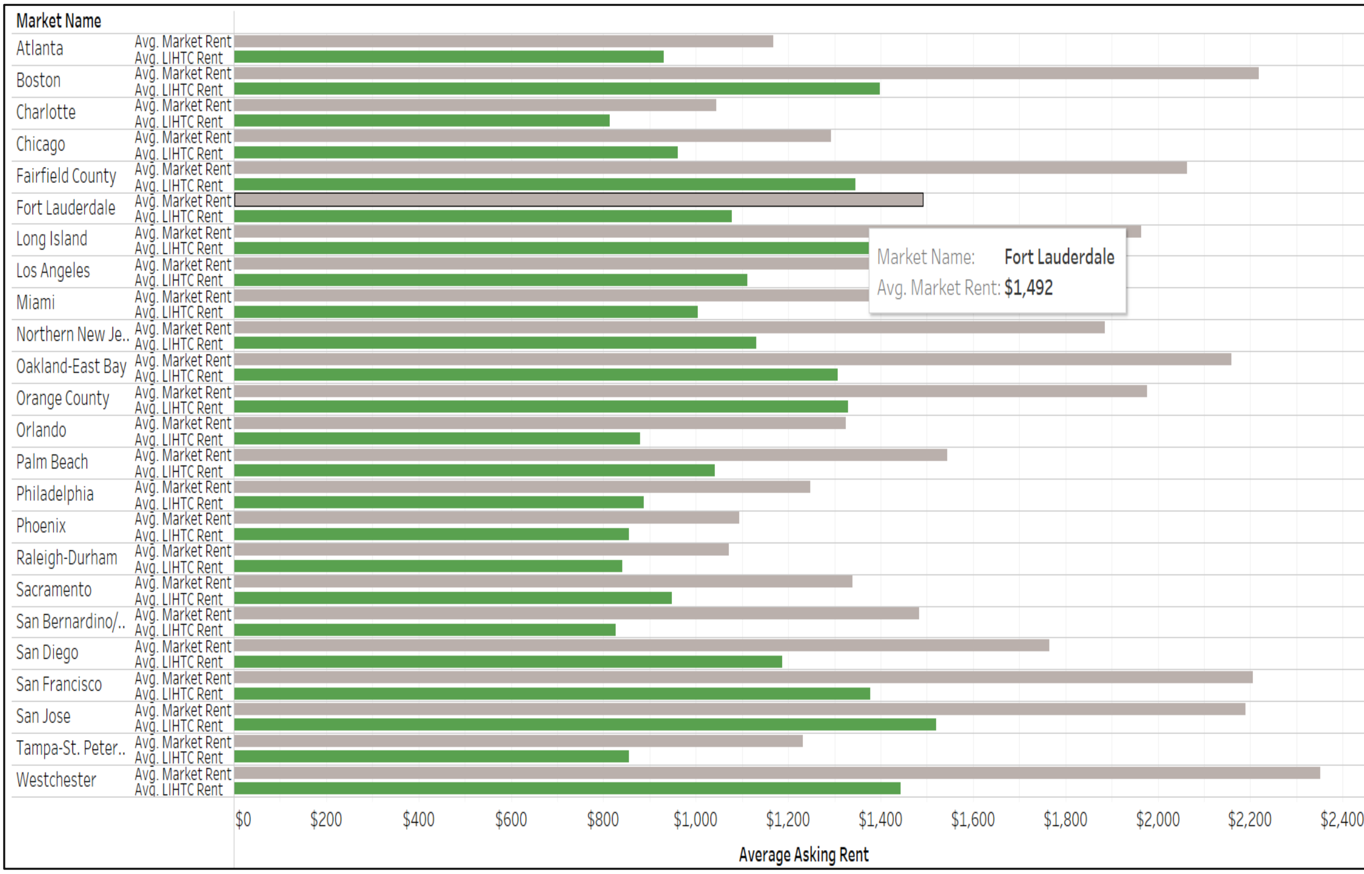


Source: Moody's Analytics CRE

LIHTC Rents Substantially Lower than Class B/C Rents in Some Metros

Even when comparing more affordable Class B/C units to LIHTC units, LIHTC rents can be substantially more affordable, as shown on the chart on the next page. For instance, in **Oakland, Los Angeles, Miami,** and **Boston** average asking rent for LIHTC units as of fourth quarter 2021 was 63% or less of market rent. However, as Class B/C rents have also risen by almost 20% in some metro areas over the past year, even more traditionally affordable markets are also seeing a significant advantage in LIHTC rents over Class B/C rents. For instance, **Orlando, Tampa,** and **Fort Lauderdale** all recorded rents at LIHTC apartments that are about 70% or less of market-rate rents.

LIHTC Rents vs Class B/C Rents Select Metros as of Q4 2021



Source: Moody's Analytics CRE

LIHTC Properties Facing Challenges but Investor Interest Remains Strong

According to the National Low Income Housing Coalition's 2022 *The Gap* report, there are only 58 affordable and available rentals for every 100 renter households earning 50% AMI. These are the renters targeted by the LIHTC program. However, the LIHTC program faces many challenges. Construction costs are rising, so it is more costly to build new affordable LIHTC properties. In addition, the temporary 12.5% increase in the amount of 9% credits implemented by the Tax Cuts and Jobs Act enacted in December 2017 expired in 2021. Further, the 4% floor for 4% LIHTC credits will be less valuable in the current environment of rising interest rates, and some states have reached the cap on their private activity bond allocations. Despite these challenges, interest in the multifamily affordable asset class is growing, showing that more private capital could flow to affordable segments.

Tanya Zahalak

Economist - Advisor

Multifamily Economics and Research

June 15, 2022

Opinions, analyses, estimates, forecasts, and other views of Fannie Mae's Economic and Strategic Research (ESR) Group included in these materials should not be construed as indicating Fannie Mae's business prospects or expected results, as they are based on a number of assumptions, and are subject to change without notice. How this information affects Fannie Mae will depend on many factors. Although the ESR Group bases its opinions, analyses, estimates, forecasts, and other views on information it considers reliable, it does not guarantee that the information, estimates or forecasts provided in these materials is accurate, current, or suitable for any particular purpose. Changes in the assumptions or the information underlying these views could produce materially different results. The analyses, opinions, estimates, forecasts, and other views published by the ESR Group represent the views of that group as of the date indicated and do not necessarily represent the views of Fannie Mae or its management.