A Tale of Four Markets

The Recovery from the Recession and Lessons Learned

By Allen Feliz, TCAM

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After weathering the distress caused by the Great Recession, most low-income housing tax credit (LIHTC) markets experienced higher rents, occupancy levels, and revenues in 2010, and the vast majority of LIHTC properties continued to deliver tax benefits to investors and quality housing to residents. The resiliency of tax credit housing is cause for enthusiasm, but cannot be taken for granted. Careful underwriting and strong management were critical in weathering the economic downturn – lessons that we should draw from to prepare for any possible future housing or economic hurdles, such as another economic downturn or rising interest rates.

If you would like to learn more about current market conditions and how they impact underwriting consider joining the National Council for Affordable Housing Market Analysts for their 2011 Affordable Housing Underwriting Forum and Annual Meeting, September 8-9 at the Westin Hotel in Chicago.
This two day conference explores the nexus of tax credit development with underwriting and market analysis.

The Big Picture

The economy is recovering, slowly but steadily. After seven straight quarters of GDP growth and eight straight months of employment growth, the national unemployment rate is hovering above 9%. The country, though, has regained only 1.8 million of the 8.7 million jobs lost between January 2008 and February 2010.

The rental market appears to be recovering more robustly than employment. Average apartment rents and occupancy declined during 2008 to 2009, but increased from 2009 to 2010. The national rental vacancy rate decreased to 10.2% in 2010, and average rents are rising after remaining flat in 2009.

Virtually all metropolitan rental markets, including some of those hardest hit by the economic downturn, showed similar declines in 2009 followed by recovery in 2010. However, the extent of the economic decline and the strength of recovery have differed greatly from market to market. How tax credit properties fared through the downturn depended both on local market conditions and other factors. Comparing property-by-property performance within the same market, as well as performance across markets, can be very instructive in suggesting ways to ensure that LIHTC assets can withstand future challenges.

Atlanta: Improving Operations, Even in a Tough Market

The Atlanta metropolitan area is one of the hardest-hit affordable housing markets. But even here, some properties are performing much better than others. Before the recession, Atlanta, like many other Southeastern and Southwestern markets, saw significant economic growth and a growing supply of – and demand for – multifamily rental units. Then the recession hit. Huge job losses caused renters to leave the area or double-up with friends and families, while foreclosures increased the supply of affordable units from owner-occupied homes converted to rental units. The market distress caused widespread problems for LIHTC properties. The overabundance of affordable units coupled with lower renter demand eroded the market advantage of LIHTC rents, causing downward pressure on property rental revenues. The hardest-hit LIHTC properties were those originally underwritten (typically during 2004-2007) assuming continued high future growth in demand and rents. These projected increases did not materialize when the economy crumbled.

Recent trends in rents and occupancy suggest that the Atlanta rental market is improving, although not as quickly as the national averages.

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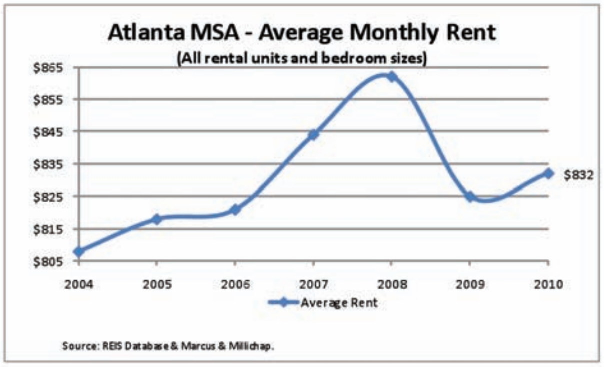
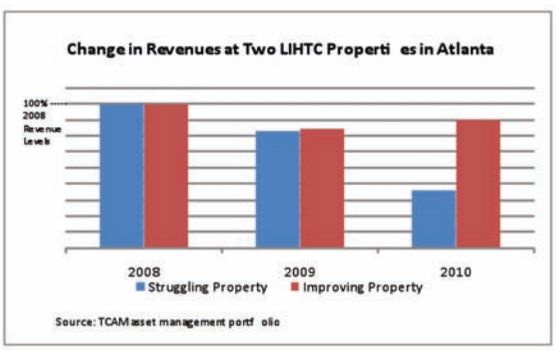


Through March 2011, Atlanta has regained approximately 5,000 of the 109,000 jobs lost between January 2009 and January 2010. Yet some properties have managed through the downturn much more successfully than others. The following chart compares the rental revenues of two LIHTC properties in Atlanta facing similar market conditions. As the recession took hold, both experienced declining revenues, from 2008 to 2009. However, even as the market continued to stagger, one property improved revenues in 2009 and 2010, while the other continued to hemorrhage. At the struggling property, the site manager was unable to neither deter crime nor bring adequate attention and resources to marketing and leasing. The improving property faced similar difficult market conditions, but the manager took steps that increased occupancy levels in 2009 and 2010.

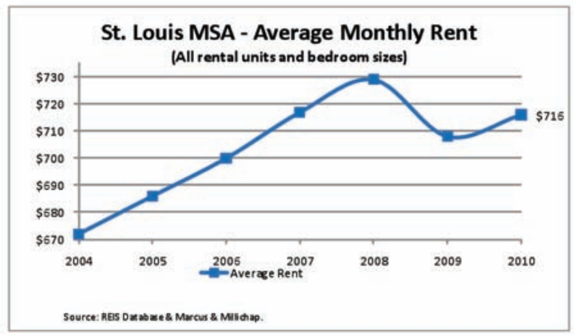


St. Louis: Weathering the Storm in a Recovering Market

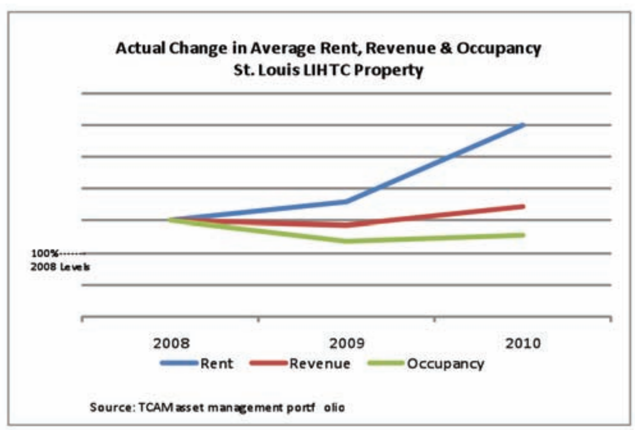
In certain recovering markets, such as St. Louis, recent market-wide rent trends have been encouraging. However, these averages hide widely varying performance across properties.

The St. Louis area, like other markets in the Midwest, did not experience the pre-recession economic boom and increase in rental units that Atlanta and other Southeastern and Southwestern markets witnessed. Therefore, the decline in affordable rental revenues in St. Louis was not as dramatic. Nonetheless, job losses and other ill effects from the downturn have hurt affordable housing.

Through March 2011, the St. Louis market had regained more than half of the 41,000 jobs lost in 2009. After a decline in average multifamily rents from 2008 to 2009, average rents improved in 2010, but are still below their 2008 peak.



The following chart shows key performance indicators for a St. Louis LIHTC property underwritten in 2005 with an expectation of steadily increasing rents. In addition to being squeezed by the drop in market-wide rents caused by the economic downturn, the property experienced additional, internal competition from the construction of a second phase.



The local economic downturn and the extra competition from the second phase initially caused occupancy at the property to dip slightly. However, effective leasing and marketing efforts by management increased rents and even improved total revenues. Without strong property management, this property would have shared the substandard performance of many other local LIHTC properties.

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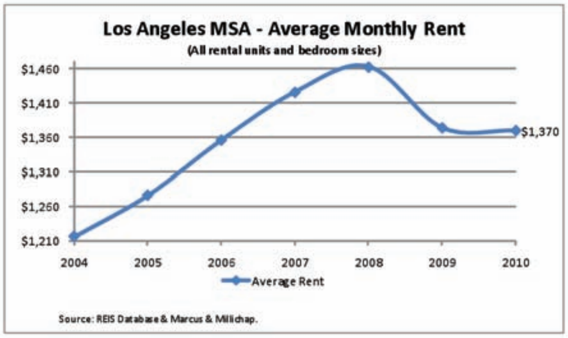
Los Angeles: The Advantage of a Strong Market

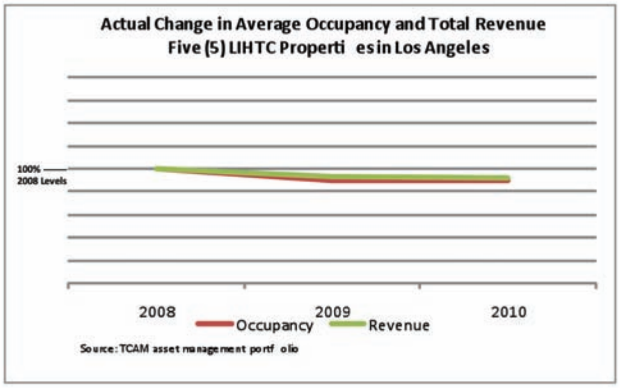
The Los Angeles area, among the strongest markets in the country, also experienced economic pressures during 2008-2010 similar to Atlanta and St. Louis. However, the overall performance of LIHTC properties remained steady through the downturn.

Continually high renter demand for affordable units and a firm market advantage have shielded LIHTC properties in Los Angeles from the negative impacts felt by tax credit properties in weaker markets.

After losing 255,000 jobs during 2009, Los Angeles has recovered about 46,000 jobs since January 2010. From 2008 to 2009 the average apartment rent declined in Los Angeles, from $1,463 per month to $1,374 per month, and it held constant from 2009 to 2010. However, LIHTC properties in Los Angeles have been less affected by economic and supply changes than conventional apartment properties.



As is the case in other strong metro markets such as New York, Washington, and San Francisco, LIHTC rents in Los Angeles have historically been significantly below market rents. As indicated by the chart below, LIHTC properties in Los Angeles experienced little change in occupancy and revenue levels during 2008-2010.

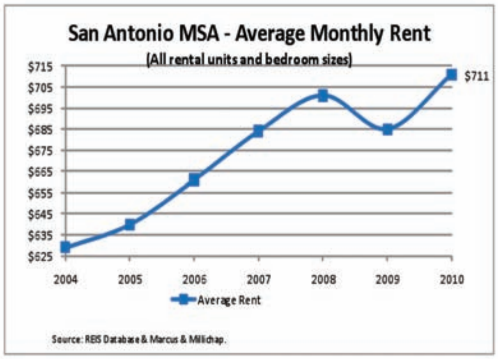


San Antonio: Focused Management in a Rebounding Market

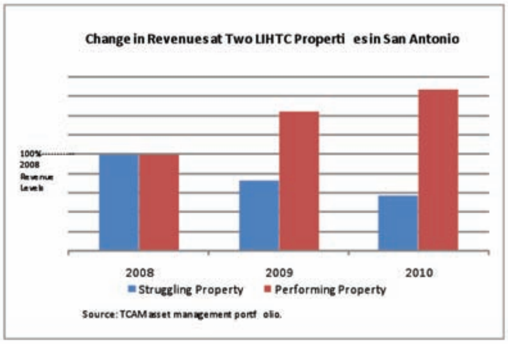
The experience in the San Antonio, Texas area reminds us that even the full recovery of a rental housing market does not guarantee success for LIHTC properties.

During the recession, San Antonio benefited from a relatively strong healthcare- and military-dependent job base. As the recession took hold in 2008 and the local supply of rental units decreased, average monthly rents continued to increase. However, in 2009, the combination of job losses and a spike in the multifamily supply caused a decrease in average rents. From 2009 to 2010, new unit completions decreased by 44% while rents rose by 4%.

San Antonio has recovered all 8,000 jobs that it lost in 2009, and has even had a net gain of 13,000 jobs since January 2010. Meanwhile, the average apartment rent by year-end 2010 surpassed the previous peak set in 2008.



Even in this well-performing market, however, individual LIHTC properties have performed differently, as illustrated by the following chart.



The struggling property did not recover from the market downturn in 2009 even though the local economy improved. During the downturn, property management was inconsistent and unfocused; in fact, the owner changed property management companies during 2008.

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Trying to achieve benchmarks originally set in the managers did not adjust to changes in the market and made poor decisions about tenant selection and pricing. These decisions ultimately took a toll on property revenues and operations. The performing property, on the other hand, thrived during this period mainly because management maintained high economic occupancy each year (97%) while improving rent collection efforts and minimizing bad debt.

What Have We Learned?

The vast majority of LIHTC have continued to deliver investment benefits and quality housing through the downturn, and many affordable housing markets may be on an upward swing. But the downturn posed challenges for many markets, and many LIHTC tax credit properties have not yet fully recovered from the fall-out.

Some of the lessons that we have learned from this period include that:

- Careful underwriting of properties is critical;
- Enhancing leasing and marketing efforts to strategically position a property within the market to compete favorably with other LIHTC properties and with comparable market-rate properties is vital;
- Proper screening of tenants and maximized collection efforts are crucial; and,
- Preserving a property's curb appeal and resisting the temptation to skimp on maintenance expenditures are paramount.

With the current economic recovery burdened by uncertainties and still saddled by high unemployment in many markets, LIHTC owners and managers are well advised to identify and resolve performance issues at their existing properties and to structure new transactions such that they will be able to weather the next possible storm. To date, LIHTC properties have continued to outperform other real estate asset classes. However, the pockets of continuing distress underscore the importance of careful underwriting and attentive and effective management. TCA

Allen Feliz is Director for TCAM, a Boston-based independent investment manager, providing asset management and advisory services to owners of real estate and renewable energy assets. TCAM's clients include owners, lenders, investors, guarantors, and syndicators. They are banks, investment banks, insurance companies, corporations, foundations, state allocating agencies, housing finance agencies and authorities, syndicators and developers. Feliz may be reached at 617-717-6071, afeliz@tcamre.com.

In Brief

Morgan Stanley, NEF Announce New Disaster Relief Funding

Morgan Stanley and National Equity Fund, Inc. have announced a new disaster-area development program to accelerate affordable housing construction and create jobs in regions devastated by recent storms, floods, and tornados. It includes a $100 million low-income housing tax credit fund that Morgan Stanley is establishing that will target disaster areas in 13 states plus $4 million in NEF predevelopment financing, to help projects move forward more quickly than they otherwise would. The goal is to slash as much as six months off the typical development time in hard hit areas to move displaced residents into homes sooner. Projects must begin construction by March 2012 to qualify.

(http://tinyurl.com/3fhzw45)

AEGON Adds Property to Google Fund

AEGON USA Realty Advisors, LLC has added a property in Honolulu, Hawaii to a $47 million proprietary low-income housing tax credit investment fund set up for Google. The Towers at Kuhio Park Terrace is a public housing community composed of two, 16-story towers. Equity from the fund will help finance the rehabilitation of the property. The fund's first tranche closed earlier this year and included a $28 million investment in two low-income housing developments in Minneapolis, Minn., and Santa Fe, N.M.

Red Stone Partners Announces New Bond Transactions

New York-based Red Stone Partners has announced the closing of three recent affordable housing transactions utilizing its tax-exempt bond private placement program. In each transaction Red Stone purchased tax-exempt bonds issued for 4% low-income housing tax credit properties. Red Stone acquired $18 million in tax-exempt and taxable bonds to refinance two properties in Madison, Tenn.; $8,190,000 in tax-exempt bonds to finance two properties in Bloomington and Freeport, Ill., and $6,885,000 in tax-exempt bonds to finance a property in Edwardsville, Pa.

Harvard Joint Center Releases Annual Housing Report

The Joint Center for Housing Studies of Harvard University has released its annual report, *State of the Nation's Housing: 2011*. One finding of the report is that the rental housing markets are tightening, which may lead to a modest recovery in housing construction this year.

(http://tinyurl.com/4xapbgc) TCA