

LIHTC Sales Transactions 2009 Through the Rear View Mirror

In our first newsletter of 2010, we felt compelled to step back and provide a few reflections on 2009. (No, not just to punish you with reminders of a tough year in real estate!). Our clients are often surprised at the level of closing activity in the tax credit property market, in spite of the economic challenges, and are curious in the types of transactions getting done. We hope this brief overview will provide some insight.

Transactions.

During 2009, we brokered 42 fee simple LIHTC properties, representing 6,026 units, with a total real estate value of approximately \$275 million. The transactions were sprinkled over 20 states, reflecting a decent cross section of the country. Separately, we also provided valuation, negotiation and closing support on an additional 24 transactions involving the purchase of either a general partner or limited partner interest. One trend that emerged in 2009, and we expect to continue, is the increase in the number of partnership buyouts that we are involved in. This is being driven by a host of factors including the age of the properties relative to the tax credit compli-

Two-Year Fee Simple Track Record		
Closed	2009	2008
Properties	42	47
Units	6,026	6,341
States	20	16
Dollar Volume	\$275,002,365	\$285,960,650

24 GP Buyouts of LP Interests Not Included (2009)

2009 Fee Simple Regional Track Record		
Region	Transactions	Volume
Midwest	14	\$34,399,900
Mountain West	6	\$29,165,000
North East	4	\$83,078,170
South East	7	\$33,841,500
South West	4	\$27,575,000
West Coast	7	\$66,942,795
Total	42	\$275,002,365

24 GP Buyouts of LP Interests Not Included

ance period, lower valuations and partner liquidity needs.

Who is Buying?

The buyer of a Section 42 asset represents a fragmented group. Although the profile of individual properties influences the type of buyer, the market typically includes a mix of buyers that can be characterized according to their sphere of buying interest. The dominant group is the buyer who owns and is buying primarily within a designated geography comprised of several states (Regional Buyers).

On a related note, we track the number of buyer offers we receive during the sales

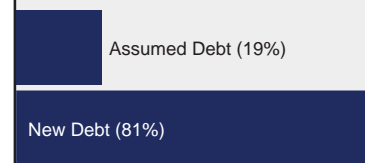
process as one gauge of market demand. Surprisingly in this market, we received an average of 11 initial offers on closed deals in 2009 compared to our historical average of 5 offers.

Financing.

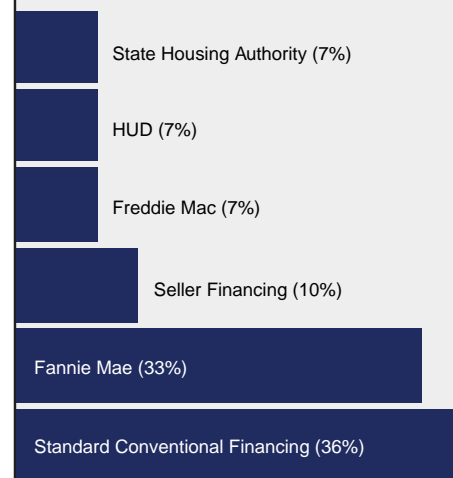
The substantial majority of the fee simple property sales involved new buyer debt. Approximately, 81% of the buyers used new debt while 19% were structured as debt assumptions.

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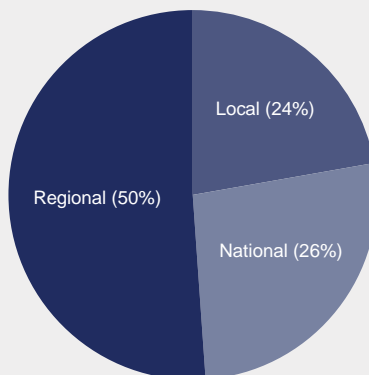
Assumptions vs. New Debt



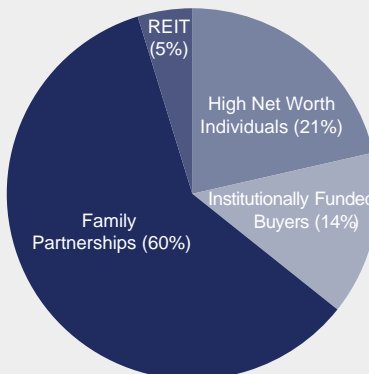
New Debt



Buyer Focus



Buyer Types

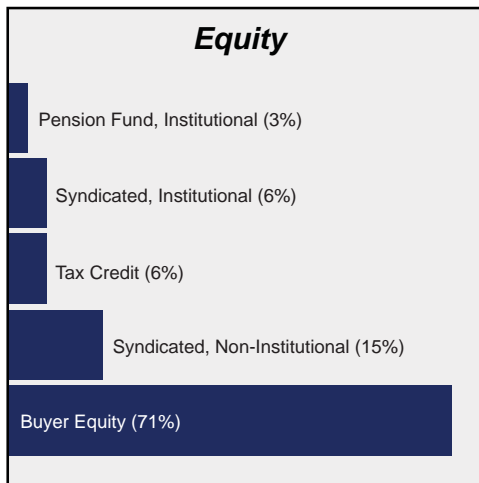


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Debt financing was sourced as follows: 40% used Fannie or Freddie debt, HUD debt was 7%, and the balance was a mix of conventional and seller financing. Two of the transactions were purchased all cash.

The vast majority of equity used for the purchase of tax credit properties in 2009 came from buyer's syndicating equity from private sources. This represented 86% of the transactions. Another 9% of the transactions represented buyers utilizing institutional sources of equity.



Return Characteristics.

Based on 285 properties analyzed, the majority of our transactions during 2009 and 2008 were fee simple executions. The table below reflects some key metrics surrounding the underwriting and valuation of the properties. The take-

aways are, not surprisingly: near-term cash flow was a key factor in deals that closed, overall buyer IRR requirements have been rising and property vacancy has increased in the face of the tougher rental environment. Buyers, on average, expected double-digit cash flow in their first year of ownership. Of course, the statistics noted below vary considerably based on facts and circumstances as well as geographies.

Transactions Can Get Done.

Even though transactions got done in 2009, we would not want to give the impression it was smooth sailing (in fact, we would be lying if we did). To leave you with some levity, one transaction deserves special mention as the "hair puller" of 2009! This property was 60% occupied, lots of negative cash flow (you may have guessed that), general partner and limited partner were refusing to provide funds, debt was nine months in default and the property teetered on foreclosure, consents to transfer ownership were not forthcoming and, finally, partners were in litigation over the reserve accounts. It was the perfect storm, but the property was ultimately purchased by a first-time LIHTC buyer who was able to work with the lender and assume the existing debt.

We hope you found the 2009 information interesting, here is hoping for a better 2010!

Fee Simple Returns	Closed Transactions		Proposals	
	2009	2008	2009	2008
Averages				
Average No. of Units	136	131	138	146
Cap Rate	7.35%	6.93%	7.48%	6.88%
Cash/Cash Return - Current	5.28%	5.99%	7.40%	5.52%
Cash/Cash - First Year	11.06%	10.59%	9.79%	9.33%
IRR	19.81%	19.41%	18.07%	16.81%
Vacancy	10.46%	6.83%	9.95%	7.53%
Loss-to-Lease	1.49%	4.91%	1.79%	2.59%
Variable Exp. Per Unit	\$2,546	\$2,314	\$2,635	\$2,722
Total Exp. Per Unit	\$4,897	\$3,861	\$4,623	\$4,611

All data is based on current operations at the time of close or analysis, except as noted.

Q&A With a Syndicator



Corine Sheridan has 25 years of affordable multifamily housing experience including transaction structuring, originations and underwriting of Section 42, tax exempt bond, HUD, and market rate housing. For Boston Capital, Ms. Sheridan and her team are responsible for the sourcing and analysis of LIHTC equity transactions nationwide.

What is the overall mood in the syndication world these days?

I think it's more optimistic than it was a year ago. We're seeing business start to ramp up again. Everyone is hearing about it nationwide, with a note of caution regarding weaker markets where unemployment rates are still high and rents are stagnant. We're paying attention to markets where tax credit rents are at or even higher than market rents. But overall I'd say the mood is much more optimistic than last year.

Is it a competitive marketplace for syndicators like yourself?

There's always been a lot of competition for investors. I think that Boston Capital has been incredibly smart in the way that we have attracted our investors - with a 35-year track record of funds and successful transactions - but yes, there's still competition among syndicators and other financial advisors that are chasing after investor dollars, though I think recently there has been more of a meeting in the middle. Investors have been attracted to the higher yields and they're seeking out those syndicators and/or funds with good track records.

On the deal side, for a while there was

very little if any competition for deals that were not in the very highest of CRA markets, and I would have to say that those markets are still the most sought after. I will say we are starting to see and hear of competition for deals in non-traditional CRA locations like the lower Midwest. There are regional banks, local banks, and funds that have been put together for some of those markets. So I'd say it's starting to pick up again.

Do you think any legislative ideas under consideration will impact 2010?

It's tough to speculate about – but I, along with others at Boston Capital, Bob Moss and David Gasson, who are much more active on the political scene than I am, feel quite confident that the Exchange Program will get extended.

The \$1 Billion earmarked for the National Housing Trust Fund could have great implications for the program this year. Now whether or not there is a hard source of money remains to be seen.

There's also the "Five-Year Carry Back" idea which would allow tax credits to offset prior tax liabilities over five years – but my guess is that when the congressional session starts up again in full, these issues may take a back seat to health care and all the other monumental problems that are going on.

Is HUD headed in the right direction?

I have been very excited about the new leadership at HUD. You'd be hard pressed to find two other people who know more about this business than Shaun Donovan and Carol Galante. It will be a huge effort to make changes – but they have done more in the last year than we have seen accomplished in the last ten years. They also bring much more awareness of LIHTC to HUD. Before now, there wasn't much recognition of the Section 42 program there.

What sort of terms will be required from investors this year?

Since about a year ago operating deficit guarantees have been about six months, remain-

ing in place for five years. It used to be three months and three years. So it has become the norm to say "minimum of six months, operating expense debt service and replacement reserves held for five years". Depending on the deal of course, you may need a larger reserve, but that has always been the case. It always depends on the deal and the sponsor, but last year we made very, very few exceptions. Going forward, who knows, but I don't see that changing much. I think everyone agrees that underwriting fundamentals should remain strong.

Has your internal process changed in the new marketplace?

There is a lot more awareness on a daily basis of our investors' needs. As deals come in the door we put a lot of thought into who may want the deal, or if it's a multi-investor fund deal. In the "good old days" two years ago, deals came in, we put them in the system, and more than likely they would go into a multi-investor fund. Now the level of awareness has been raised and we consider every option carefully. As far as staffing is concerned, we haven't had to make changes. We kept our due diligence and underwriting processes in place.

Are you seeing different kinds of investors?

The two major focuses are still financial institutions of all different kinds, and insurance companies. At least with Boston Capital and from what I hear of other syndicators, these are still the primary investors. Then to a lesser degree we're seeing consumer goods type companies, and some technology firms.

Has the distribution of cash flow changed much?

Most of the ones we've been doing lately are 70/30 depending on the deal. Of course a few years ago it was usually 80/20 and even 90/10 was not uncommon.

What is your ratio of 4% to 9% deals?

Four percent deals of course, kind of died

out over the last year and a half. However, we have done some recently. They are mostly in CRA locations, and/or they are with long-term clients of Boston Capital. I would say our funds are maybe 20 percent 4% deals and 80 percent 9% deals. So we're willing to look at them. If a 4% transaction can be made to look pretty close to a 9% transaction, and the other fundamentals in the deal are strong, it can make sense. You've got to have a strong sponsor, and obviously you've got more debt so you've got to have an incredibly strong market and the ability to have some gap between the tax credit rents and the market rate rents.

As far as what 2010 holds, I would say it depends on the states' or localities' ability to generate buyers for the bonds. I know some of the state agencies went into a real tailspin when they couldn't sell their bonds. I believe that has picked up again in some locations.

Describe your last transaction.

Believe it or not it was a bond deal! It was an acquisition/rehab in an urban Virginia location – part of the Washington, D.C. MSA. It was a small deal, but Virginia has traditionally been a hot CRA market for us and it was with a strong sponsor. Tax exempt debt was issued by the state with VHDA bonds. It had probably \$40K per unit in rehab, but it worked. None of these closings are easy, but it worked and we would do another one – but again, it was because of a very strong sponsor, a strong urban market, and a strong CRA market. If this deal had been in a weaker market we wouldn't have done it. It also happened to be the very first deal with this sponsor, so I felt like we went out on a limb a bit.

Any final thoughts?

We are seeing more investors back in the market. Maybe they were in a long time ago and now they're back. So 2010 has a healthier feeling already.

Market Spotlight: Philadelphia

Value Disconnect Between Buyers, Sellers Continues to Narrow

Operational performance in the Philadelphia apartment market is expected to remain soft in the near term, although limited development activity and a projected resumption of job growth point to long-term stability. Despite the uptick in completions later in the year, stock will increase by a meager 0.5 percent. Further, the new units that are scheduled to come online are located in areas of higher rent demand, including the Lower Merion and Central Chester County submarkets. Consequently, the deliveries should not significantly affect vacancy. On the demand side, easing job cuts through midyear will be followed by limited hiring, helping to steady apartment demand. Employment will continue to strengthen over the long term as more companies expand and begin to rehire. Fisker Automotive, for instance, recently agreed to purchase the shuttered General Motors plant in Wilmington. The firm will create 2,000 factory jobs and 3,000 vendor positions by 2014.

Investment activity may pick up in 2010 as the pricing disconnect between buyers and sellers continues to narrow. Owners who are seeking exit strategies might consider listing assets, as rising expenses and property taxes, along with minimal rent gains, will likely suppress near-term income growth. Investors, meanwhile, may increasingly realize that the bottom of the

market was nearly reached last year, highlighted by historically low interest rates, increasing cap rates and struggling NOIs. Cap rates currently average in the 8 percent range and appear to be stabilizing, although softer fundamentals may apply downward pressure on pricing in the near term. Over the long term, Philadelphia will remain a stable market for apartment investment due to expectations for steady employment and a slowdown in supply additions.

Employment Forecast

A year after 65,000 positions were removed from the metro last year, employers are expected to add 18,000 jobs to Philadelphia payrolls in 2010, an increase of 0.7 percent.

Construction Forecast

Completions will total approximately 1,000 apartments this year, up from 500 units in 2009. Over the past five years, annual deliveries have averaged 1,500 units.

Vacancy Forecast

Limited supply-side additions will keep vacancy in check. In 2010, vacancy is forecast to rise just 10 basis points to 6.6 percent, following an 80 basis point increase last year.

Rent Forecast

This year, asking rents are forecast to drop 1.7 percent to \$985 per month, and effective rents are projected to fall 1.9 percent to \$928 per month. In 2009, asking and effective rents declined 2.1 percent and 3.9 percent, respectively.

Investment Forecast

Low interest rates and higher yields may attract more investors to Philadelphia apartment assets. Owners considering exit strategies could contemplate selling due to the likelihood of minimal near-term growth and higher operating expenses.

2010 MARKET FORECAST

Employment:	0.7% Up
Construction:	100% Up
Vacancy:	10 bps Up
Asking Rents:	1.7% Down

The information contained in this report was obtained from sources deemed to be reliable. Every effort was made to obtain accurate and complete information; however, no representation, warranty or guarantee, express or implied, may be made as to the accuracy or reliability of the information contained herein. Note: Metro-level employment growth is calculated using seasonally adjusted quarterly averages. Sales data includes transactions valued at \$500,000 and greater unless otherwise noted. Sources: Marcus & Millichap Research Services, Bureau of Labor Statistics, CoStar Group, Inc., Economy.com, National Association of Realtors, Real Capital Analytics, Reis, TWR/Dodge Pipeline, U.S. Census Bureau.

Tax Credit Group: Current LIHTC Activity

	Closed	Escrow/Mktg.	Total
Properties	250	18	268
Units	36,345	2,842	39,196
States	35	11	-
Dollar Volume	\$1,610,625,843	\$103,528,941	\$1,714,154,784

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