Tax Cuts and Jobs Act:
State of the Investor Market

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History has taught us that while uncertainty fuels anxiety, dealing with uncertainty is a must-have skill for living in rapidly changing times. Thirteen months ago, we lived in an environment where we fought to preserve not just the housing tax credit program, but its production power. While we haven't tallied up the 2017 industry equity volume and production figures yet, all of us deserve a pat on the back for achieving the preservation task and saving the industry from devastating changes, such as eliminating the Private Activity Bonds, which comprise 50% of the nation's affordable housing production.

Our most recent study, based on data collected on more than 22,000 housing tax credit properties, confirmed once again that nearly all affordable housing units across the country are close to being fully occupied. The housing tax credit program not only has been one of the most impactful tax incentive programs, but also has proven to be a safe and sound investment for investors, as evidenced by a cumulative foreclosure rate of 0.71%.

Now, with the most sweeping tax overhaul a certainty, what is ahead for us in 2018? We anticipate that, as was the case 13 months ago, the equity market will take some time to evaluate impact and reset business strategies. Undoubtedly, housing credit investments will be devalued due to several factors, mainly:

- A lower corporate tax credit, which, without investors accepting a lower yield, would reduce pricing by $.0.04 to be yield-neutral. Note that for a "typical" 9% transaction, every 1% drop in corporate tax rate requires a corresponding one cent drop in price to hold the investment yield constant. The market reacted exactly this way: from December 2016 to December 2017, we saw a $0.10 drop in pricing to a national median of $0.92, with most deals underwritten at a 25% hypothetical tax rate. It remains to be seen how the equity supply/ demand power would reset the pricing/return targets for 2018. On the supply side, the formal return of Fannie Mae and Freddie Mac is largely viewed as a welcome outcome. Altogether, the two government-sponsored enterprises could theoretically supply up to $1 billion of equity in 2018, which might nicely fill in the gap left behind by investors temporarily exiting or reducing their investment volume, while providing some diversification to the market.

- The Base Erosion and Anti-Abuse Tax (BEAT) could depress the value of housing tax credits by 20% through 2025 or 100% after 2025 for those foreign-owned investors or investors with significant overseas operations. While it is not hard to name foreign-owned investors, assessing impact to BEAT-affected multinational corporations is not as straightforward.

Needless to say, there will be some impact felt by the market. We are hearing discussions involving secondary transactions. On the flip side, anticipated economic growth and repatriation of profits could ultimately increase investors' tax appetite.

Besides establishing 2018 business strategies, investors continue to incorporate changes in their asset management practices. First, the concept of a 15-year tax advantaged asset in a stable corporate tax rate environment has proven to be outdated. Proactive investors have begun to upscale their tools to better understand impact to their existing portfolio in a real-time, more dynamic fashion.

We expect that the investor community will soon reset standards to guide investor reporting so that yield variances can be attributed to economic performance or tax rate changes. For post-election housing tax credit funds closed at 25% with protection down to 20%, adjustor amount needs to be determined. Impairment, while uncommon under the proportional amortization method, needs to be tested.

What Does CohnReznick Think?

We anticipate the market will move in relatively slow fashion in the beginning of 2018. That said, we won't be surprised to see some investors attempting to take the first-mover advantage, whether in primary or secondary transactions.

For those putting deals together, there are many technical strategies to deploy. For example, we have observed a wider application of cost segregation strategies in 2017 deals. With the 100% expensing rule, we expect to see an expanded adoption of cost segregation studies. 2018 will be another year of hard work for all of us in the affordable housing industry and CohnReznick will remain deeply involved in the industry's advocacy efforts. We will also be keeping a close eye on any technical corrections that may come out in the coming months and how the Community Reinvestment Act is being examined.

Working closely with legislators, state agencies, developers, syndicators, lenders and investors, we will continue to provide updates on how the Tax Cuts and Jobs Act will affect your business and the affordable housing industry.

Cindy Fang is a partner in CohnReznick's Boston office and serves as the Firm's Tax Credit Investment Services (TCIS) Leader. TCIS provides investment due diligence and other advisory services to institutional investors to help them strategically acquire and manage tax credit investments. Cindy had a broad range of experience serving investor, syndicator, developer, and housing finance agency clients involved in tax credit transactions. She is well-versed in all realms of major investment tax credits including the low-income housing tax credit, historic, New Markets, and renewable energy tax credits.

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