Trump Tax Plan, Not Even On Drawing Board, Is Already Roiling Rental Housing

Developers, financiers, and owners of low- and moderate-income rental housing are scrambling for patches for lost equity

By Andrea Riquier, MarketWatch, February 28, 2017

The housing development known as A.O. Flats, announced in March 2016, was hailed as exactly what Boston needed: affordable rental homes in a mixed-use building, just steps from a transit station. It would mean 78 middle-class families and residents - nurses, teachers, service workers - could afford to rent in Jamaica Plain, one of the city's most sought-after neighborhoods, an area where 2-bedroom apartments are renting for about $2,000 per month, according to Zillow.

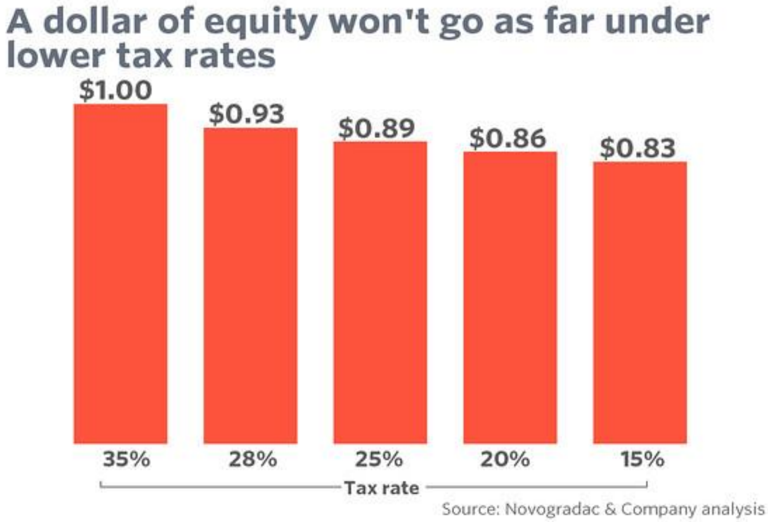
A.O. Flats was in a sweet spot, according to Bart Mitchell, president of The Community Builders, the nonprofit housing developer behind the project. "People embraced the idea of housing production being needed near transit, in a neighborhood for people with higher incomes but having it be for moderate incomes as well."

The project was supported by the City of Boston and The Community Builders and had funding through a national initiative called the Low Income Housing Tax Credit, a program that's enabled more than 43,000 housing units to be built over the past three decades.

But in November, after Donald Trump's surprise victory, planned construction on A.O. Flats came to a screeching halt. The LIHTC distributes federal tax credits to the states, which work with developers to determine the best projects to meet local needs — everything from apartments to senior housing.

Suddenly, the value of those tax credits was in question. "Corporations said, wait, there's a Republican Congress and a Republican president, there probably will be a reduction in the corporate tax rate," Mitchell said.

Ever since then, a market that participants call "extremely efficient" has been in disarray. On average, investors across the country have been discounting the value of the tax credits by about 10%. In the case of A.O. Flats, that means a $700,000 gap on a $7 million project.



Some investors are walking away from deals altogether, said Chuck Wehrwein, an executive with the Housing Partnership Network, a national network of nonprofit developers and owners. Others are lowering their funding. Many are revising deals to include “adjusters” that would re-set based on whatever tax rates become in the future.

Scrambling to Fill Gaps

Across the country, municipal agencies, developers and community organizations are scrambling to patch the gaps. Some are re-allocating funds among existing projects already in the works; some are pulling forward funds from future years’ budgets. And some deals just aren’t getting done.

The Housing Partnership Network has 100 member organizations, and Wehrwein estimates about 200 projects could be affected in some way in 2017, with a monetary impact of nearly $3 billion.

Solace Apartments is one of the projects within the Housing Partnership Network that’s now in jeopardy. The St. Peter, Minnesota development was conceived by a district court judge who kept seeing people exiting the criminal justice system with no way of accessing housing. Community organizations pulled together to try to make the development a reality, and it was seen as a potential model for other developments around the country not only for the partnerships and its mission, but also for its rural location.

Now, after years of planning, the project is stalled, with an estimated $2 million funding gap.

In some ways, the market disruption couldn’t come at a worse time.

“What’s unusual about this situation is that but for the market re-assessing the possibility of tax reform, we have been in one of the most robust investor markets in the history of the tax credit program,” said Todd Crow, the manager of the tax credit program for PNC Real Estate. “It’s been highly successful for 25 years, it enjoys strong bipartisan support politically and has performed well. We’re building affordable rental housing which is at a crisis point in most major cities in the U.S. Rents are increasing significantly faster than tenants’ ability to pay.”

It’s not just fancy urban areas where surging housing demand is driving prices up. The Solace Apartments’ local market, St. Peter-Mankato, has a vacancy rate of 2%, according to the Housing Partnership Network.

And that may not change soon, Crow said. “The market seems to be dug in for a period of prolonged uncertainty.”

Different Investors, Different Goals

Many industry professionals say a clear divide has emerged between the different investor classes in the market. Some are what Nancy Andrews, president of the San Francisco-based Low Income Investment Fund, calls “purely motivated by economics.”

Those players often include traditional institutional investors with a long time horizon, like insurance companies. But it’s often also companies not normally affiliated with the housing market, but consider the tax credit valuable, like Google. Google did not respond to a request for comment, but Andrews said many such investors are “side-stepping until the dust settles.”

They stand in contrast to regulated financial institutions, like banks, that also receive credit under programs like the Community Reinvestment Act, many of which are still trying to find ways to get deals done. “They do that because they’ve been engaged in it for not just economic reasons but also policy,” Andrews said.

Not only is this market disruption happening at a moment when the housing market can scarcely afford less capacity, but it’s happening when the cost of capital is likely to increase for developers, Andrews pointed out.

While participants like Crow say the industry is “rallying” together to find a path through the uncertainty, it’s clear it’s making a challenging mission even more so. And, while most sources who spoke to MarketWatch declined to speculate about the path of tax reform in Washington, that’s another unknown that’s weighing heavily.

“We think we can take this punch, as it were, but if it just kind of lingers on with the threat of it being done but it not actually happening, it’s going to hurt,” Wehrwein said.

He and other sources believe the program has always enjoyed strong enough bipartisan support for it to be preserved in any future fiscal reforms.

“It speaks to issues that Democrats and Republicans both care about, it doesn’t involve a lot of federal bureaucracy, transfers risks to the private market, it has an excellent track record, and the deal performance has been incredible,” said Buzz Roberts, president of the National Association of Affordable Housing Lenders, an industry group.

Still, the possibility has Wehrwein and others worried. “If Congress considered tax reform and didn’t think about keeping the credits that would be devastating to the affordable housing community,” he said. “We are already dramatically upside down in terms of the number of homes we have, and this would just cripple the ability to build affordable apartments. This is not just a city thing. It hits all of America.”