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Q&A: Steven Fayne Discusses LIHTC Rental Rate Projections

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Steven Fayne, Principal of Align Finance Partners and a member of its Investment Committee, explains how area median incomes (AMIs) will be affected due to COVID and how Align underwrites income growth when sizing prospective deals.

Will the pandemic and economic disruption impact AMIs and 2021 LIHTC rent levels?

SF: Yes and no. Since ACS data lags[1], we won't see an immediate impact to HUD's base AMIs. However, the CPI adjustment will most likely capture COVID's impact. We say this with confidence as, in July, the Congressional Budget Office (CBO) revised its estimate of 2021 CPI downward due to the economic slowdown.[2] Earlier this year, Novogradac projected that HUD would conclude a national median income of $81,200 for 2021. After the CBO's July adjustment, Novogradac revised its projection downward by 2.5 percent to $79,200.[3] In additional to providing a general indication of nationwide trends, the national median income is relevant to LIHTC rents as HUD limits the maximum increase in income limits to the greater of 5 percent or two times the annual change in national median income.[4] Based on Novogradac's 2021 estimate, the national median income will increase by 0.89 percent in 2021, meaning LIHTC income limits will be capped at a 5 percent increase over 2020.

As a consequence of COVID's economic impact, how does Align underwrite income growth when sizing a prospective deal?

SF: Unlike banks and the Agencies, we do not have prescribed growth factors or mandated exit tests. As a balance sheet lender, we can underwrite growth however we see fit. We lend in locations where there will be sustained growth and we continue to size proceeds to 90 percent LTV / 1.15x IO DSCR, with all loans having full term interest-only. We are more concerned with non-payment risk related to COVID/eviction moratoriums than we are with long term stagnation. For deals currently in underwriting, we are closely monitoring delinquency rates and will work with borrowers to find solutions that address dips in collections, such as a letter of credit, an earnout, or a guaranty.

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[1] HUD uses data from the American Community Survey (ACS) to determine AMIs. While the survey occurs annually, the results are not available immediately. Because of this, AMIs (and consequently, income limits) are based on data from prior years. For example, 2021 HUD AMIs will be based on 2018 ACS data. To account for the lag, HUD adjusts the ACS data by the Consumer Price Index (CPI). The CPI adjustment is uniform nationwide, regardless of the local dynamics.

[2] "An Update to the Economic Outlook: 2020 to 2030," Congressional Budget Office online, accessed September 17, 2020, https://www.cbo.gov/publication/56465.

[3] Thomas Stagg, "Novogradac Revises Down National Median Income Estimate by 2.5 percent," last modified July 24, 2020, https://www.novoco.com/notes-from-novogradac/novogradac-revises-down-national-median-income-estimate-25-percent.

[4] "Income Limits," HUD Office of Policy Development and Research online, accessed September 17, 2020, https://www.huduser.gov/portal/datasets/il/il12/FAQs_12.pdf.

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Do you anticipate declines in tenant-based voucher rents as a result of COVID's impact? How does Align underwrite these units?

SF: We don't envision these rental rates falling significantly, rather we believe they'll remain relatively flat. Like LIHTC rents, these voucher rents are informed by ACS data. We will consider underwriting overhang on these vouchers if there is a history of long-term tenancy or the sponsor, through a partnership with a housing authority, has demonstrated the ability to fill vacated units to tenant-based voucher rent levels.

If LIHTC rents decrease, and loan proceeds consequently fall, how will developers fill the gap?

SF: Align's ability to offer more proceeds than competitors – due to our 1.15 interest only DSCR test – becomes all the more relevant. Additionally, in July the House passed the Moving Forward Act, or H.R. 2, and the act now sits with the Senate. Among other things, this act calls for changes that would result in additional tax credits for developers. Specifically, it seeks to establish a 4 percent minimum floor rate, which is substantially higher than the 3.07 percent rate currently in effect. The act also offers additional basis boosts to eligible properties.