THE TAX CREDIT EQUITY MARKET IN 2022 AND BEYOND

CohnReznick
ADVISORY • ASSURANCE • TAX

March 21, 2022

CohnReznick LLP

WHO WE ARE

- CohnReznick LLP is the 11th largest public accounting firm in the U.S. with one of the largest and most experienced tax credit practices in the country.
- Tax Credit Investment Services ("TCIS") is a dedicated business unit within CohnReznick that provides strategic advisory and due diligence services to help clients make informed decisions on acquiring and managing tax-advantaged investments.
- TCIS is well-regarded in the industry for:
  - Having authored 2,500+ investment due diligence reports for tax credit investors; experienced with multi-investor, proprietary and secondary market transactions;
  - Having authored numerous affordable housing industry studies and spoken frequently at industry conferences and events;
  - Being sought after by the bank regulators and GAO to provide industry data and insights;
  - Publishing housing tax credit equity market trends on a bi-monthly basis in the *Tax Credit Advisor* magazine.

HOUSING TAX CREDIT BASICS

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35+ Year History

Most Successful AH Production Program

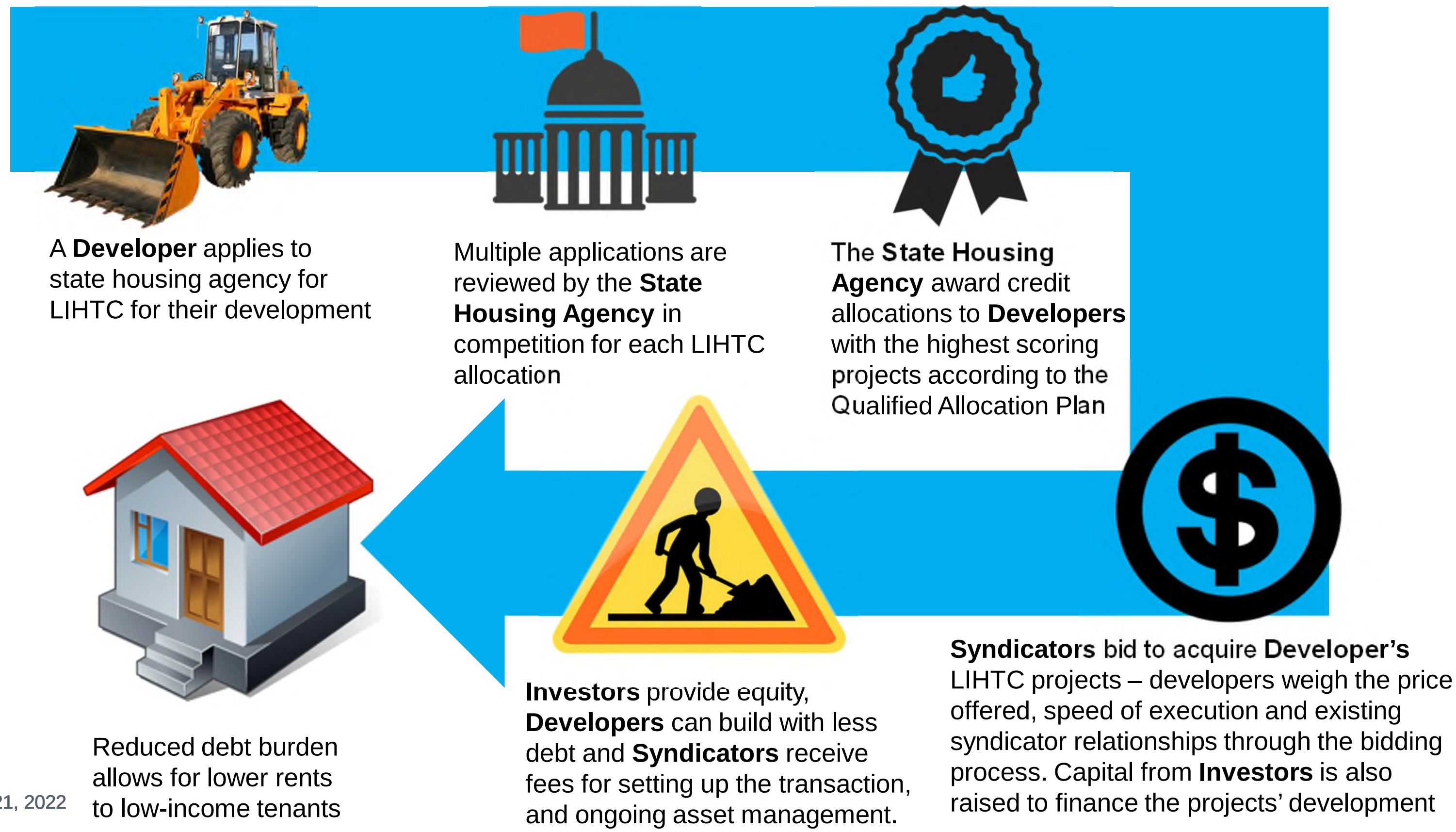
P3

10-15 Year Hold

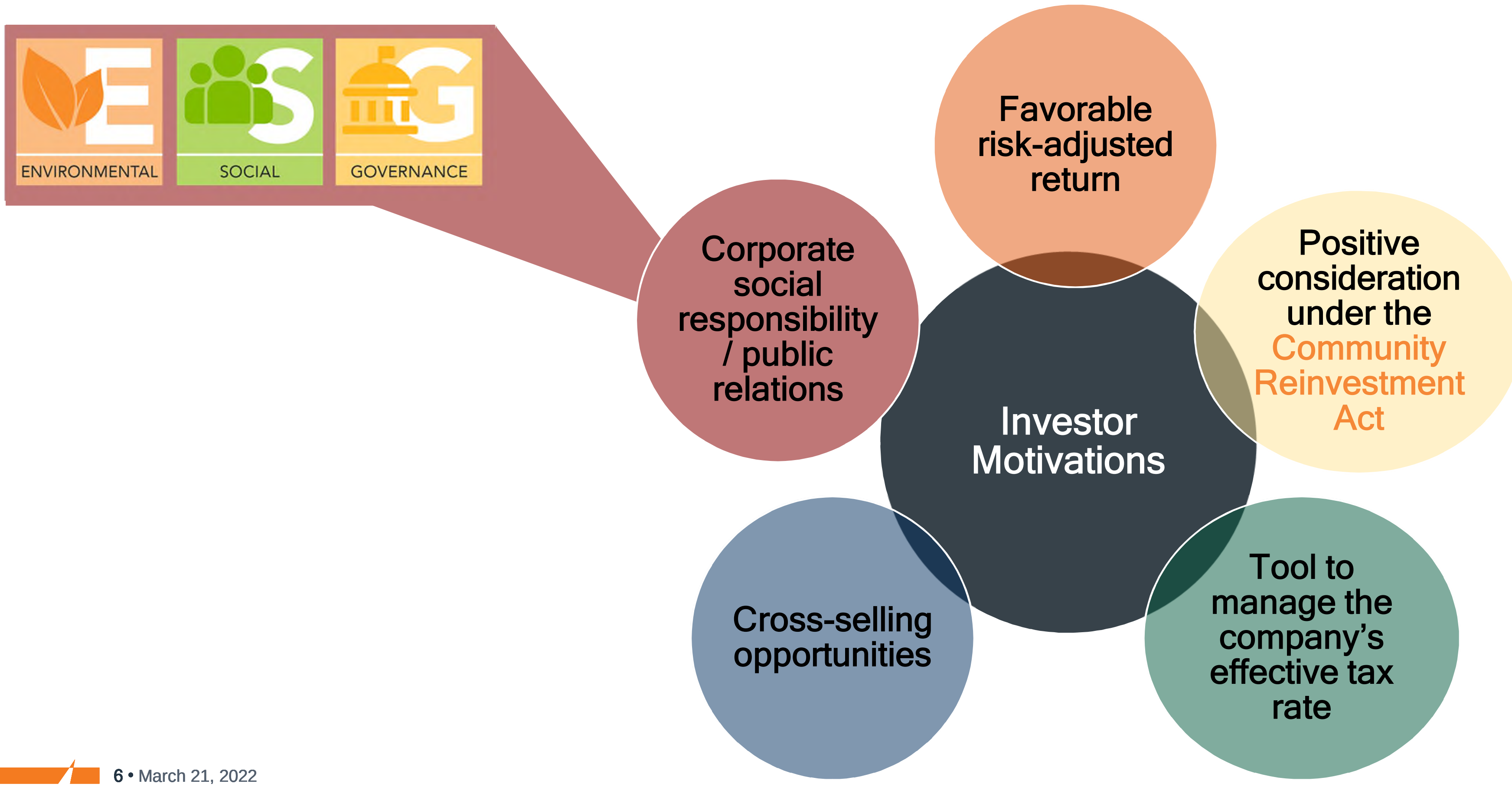
Complimentary Programs

- The Low-Income Housing Tax Credit is one of the few major federal investment tax credit programs; was authorized in 1986 and made permanent in 1993.
- Having been the most important program for creating and rehabilitating affordable housing in the US, the housing tax credit program finances the construction or rehabilitation of more than 75,000 affordable housing units every year.
- The IRS sets rules through IRC Section 42, while administration of the program resides with the state credit allocating agencies. Many states also have their own state housing credit programs.
- Credits are delivered over ten years to the equity owner of housing tax credit projects, with a 15-year holding period for compliance reasons; early exits are possible.
- In addition to housing tax credits, there are many federal and state rental assistance, and subsidized loan programs available to support the production of affordable housing.

HOW THE PROGRAM WORKS



INVESTOR MOTIVATIONS



INVESTMENT DECISIONS

- Overall Corporate Strategy and Social Impact Objectives
- Tax Appetite
  - Federal
  - State
- Risk-adjusted Return Hurdle Rate
- Method of Execution
  - Syndicated multi-investor funds?
  - Syndicator screening criteria
  - Investment guidelines

HOW DO INVESTORS CHOOSE INVESTMENT VEHICLES?

Direct investment – Investor owns a 99% LP interest in an operating partnership with the developer as GP and no third-party intermediary. A few large investors have full time staff to underwrite & asset manage such investments. This option would be difficult to execute otherwise.

Fund investment – Investors acquire LP interests in an investment fund organized by a syndicator/Fund GP. The syndicator finds and underwrites investments in a series of operating partnerships

- **Multi-investor Funds** – typically 5-10 corporate LP's, investors can typically review about 70% of the fund's property investments before committing
- **Single Investor (Proprietary) Funds** – same idea with an experienced investor keeping more control e.g. veto rights on property selection

HOUSING TAX CREDIT TIME MACHINE

Late 1980s
- **$1B** equity market
- **$0.40**/$1 credit
- Equity sourced from individuals

1993
- Corporate market developed
- Equity sourced from “C” corps

2000
- **$4B** equity market
- **$0.60**/$1 credit
- **10% IRR**

2006
- **$9B** equity market
- **$1.00**/$1 credit
- **4.5% IRR**

2008-2009
- Market meltdown
- HERA saved the day with TCAP and Exchange programs

2010
- Market rebound

2018
- **16.4B** equity market
- **$0.92**/$1 credit
- Equity sourced ~80% from commercial banks; GSEs’ return

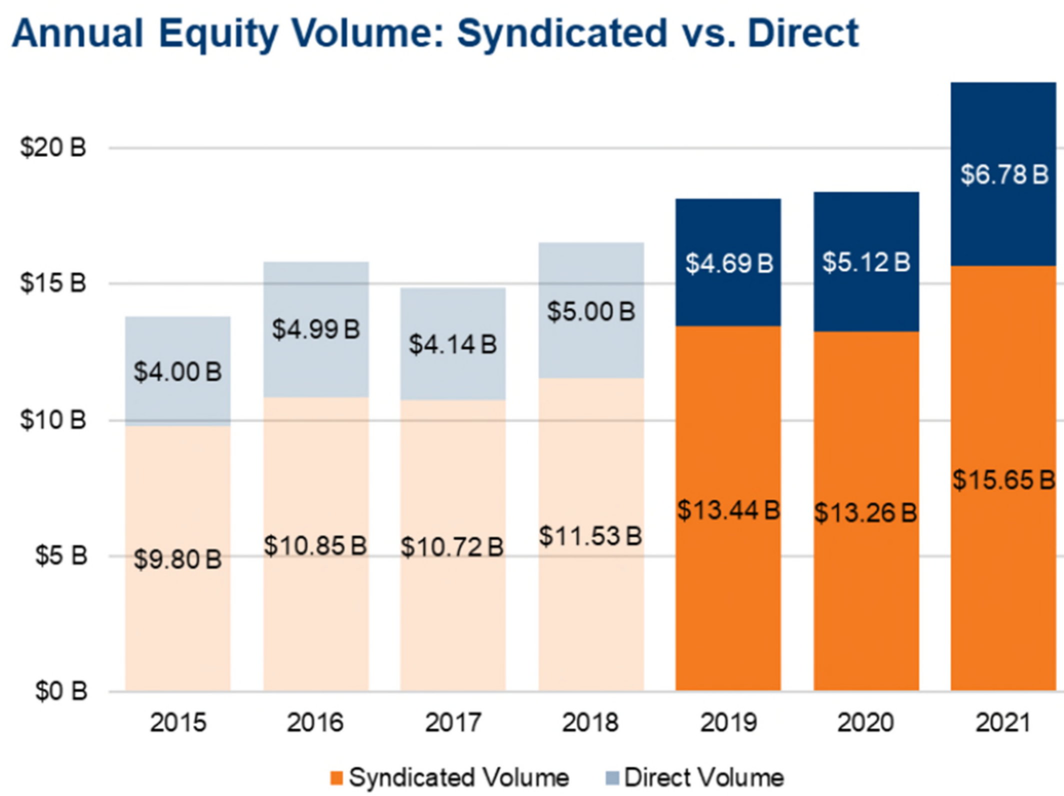
2019
- **$18.3B** equity
- $0.92/$1 credit

2022
- **$22.4B** equity
- Strong market despite COVID
- 4% fixed rate

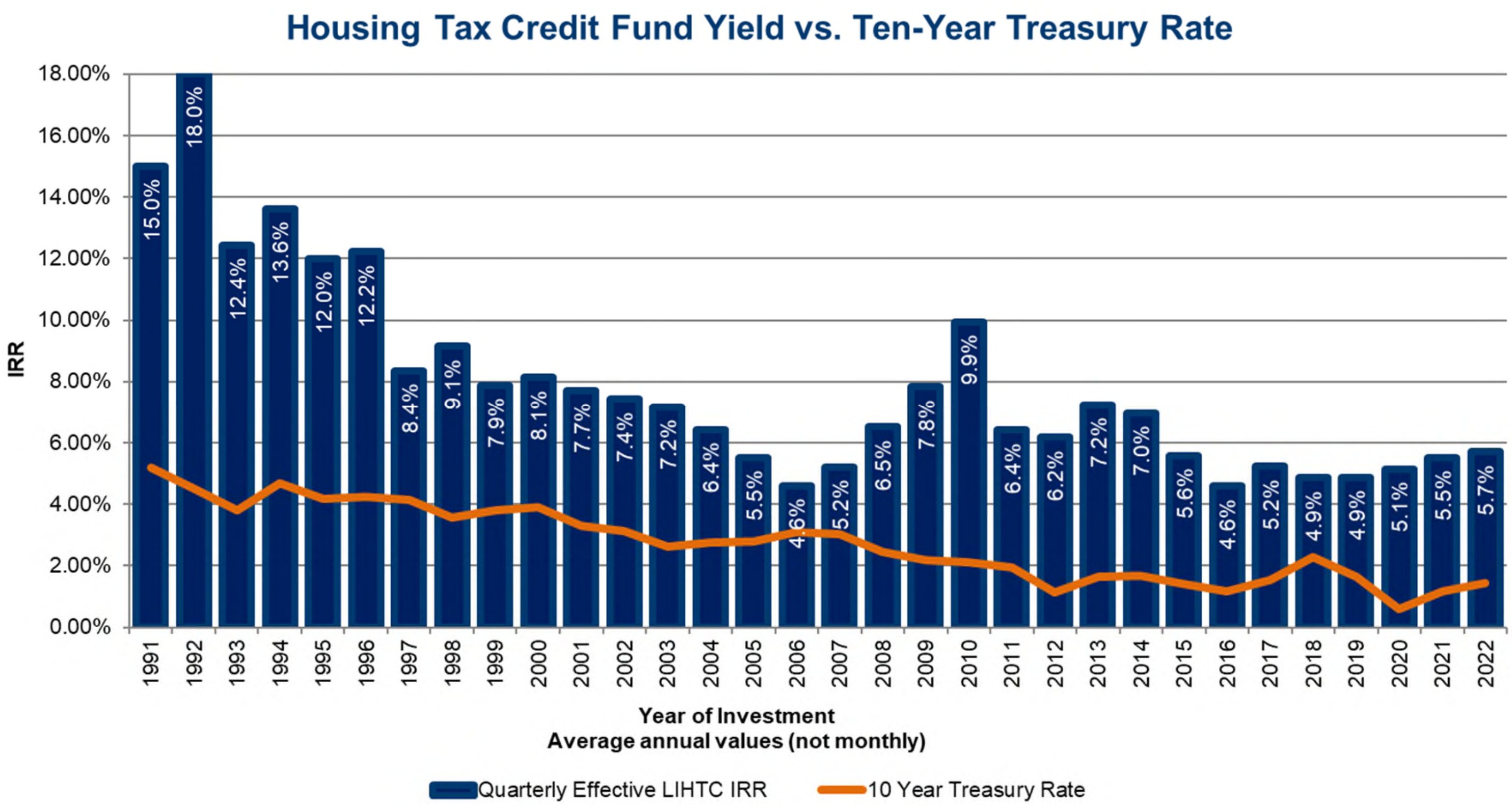
SIZE OF THE MARKET

CohnReznick's survey of federal housing tax credit market participants, including 39 syndicators and direct investors, concluded that approximately $22.4 billion of investor equity was closed into housing tax credit investments in 2021.

The increase in credit supply was largely attributable to three factors: the fixed 4% credit rate for tax-exempt bond-financed transactions that was passed into law at the end of 2020; the 12.5% increase in the 9% credit supply (which expired at the end of 2021); and various disaster credit allocations.



FUND YIELD VS. TREASURY RATE



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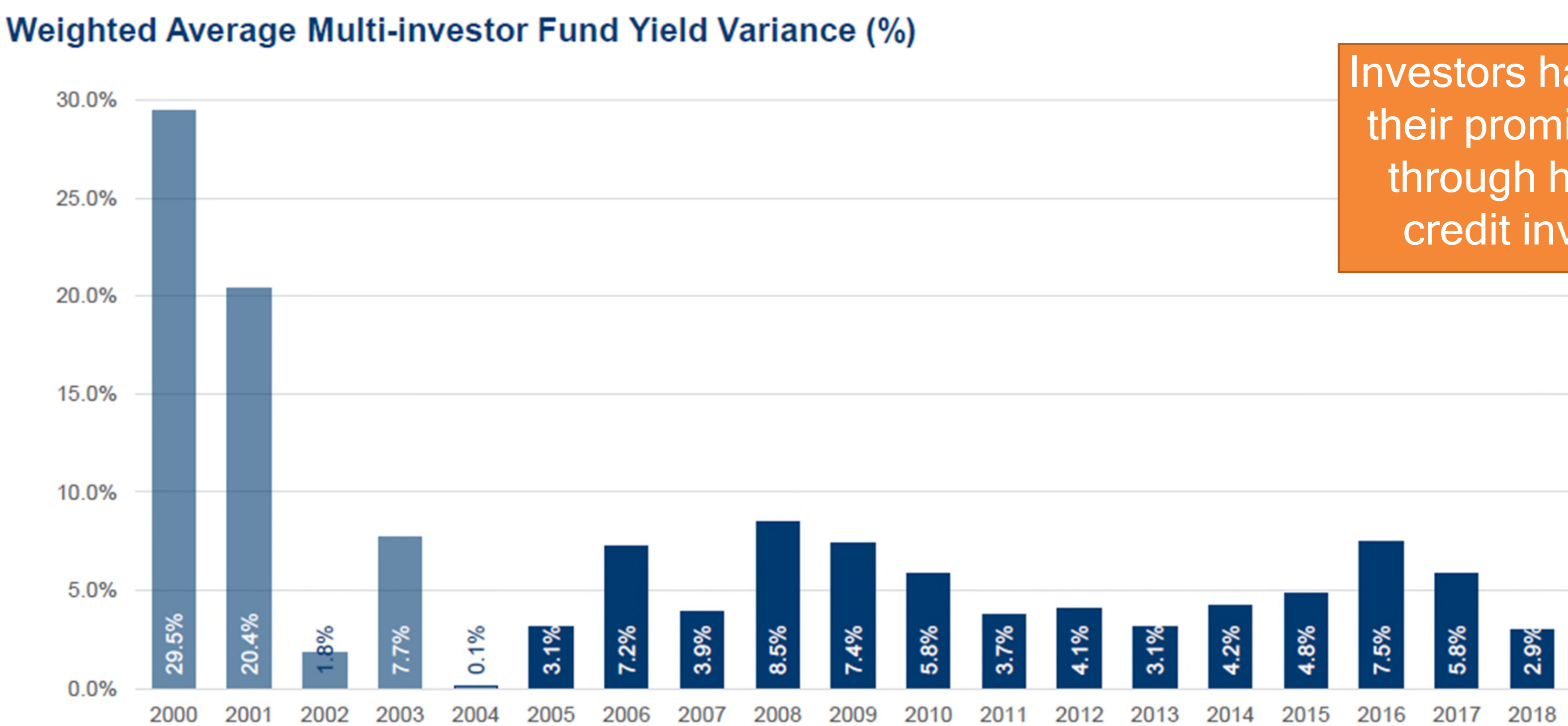
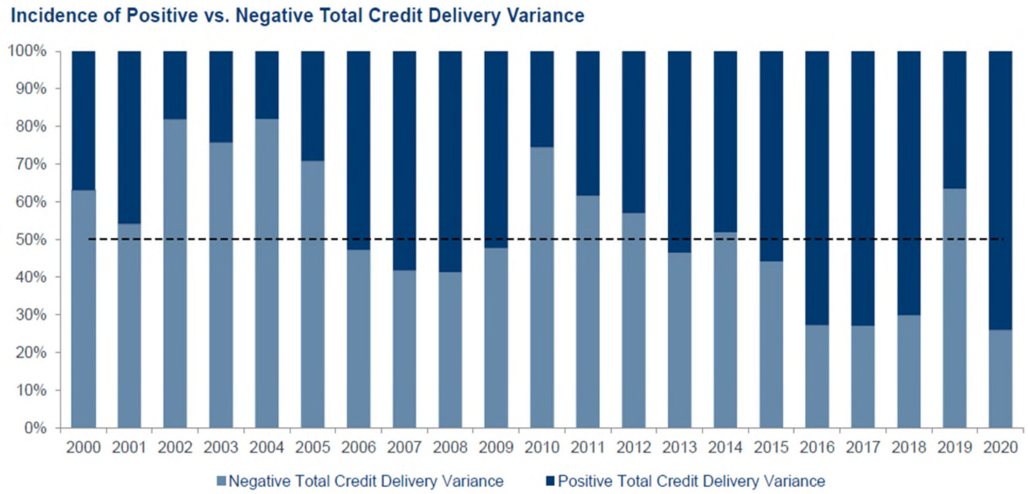
TRACK RECORD OF HOUSING TAX CREDIT INVESTMENTS

FUND YIELD DELIVERY PERFORMANCE

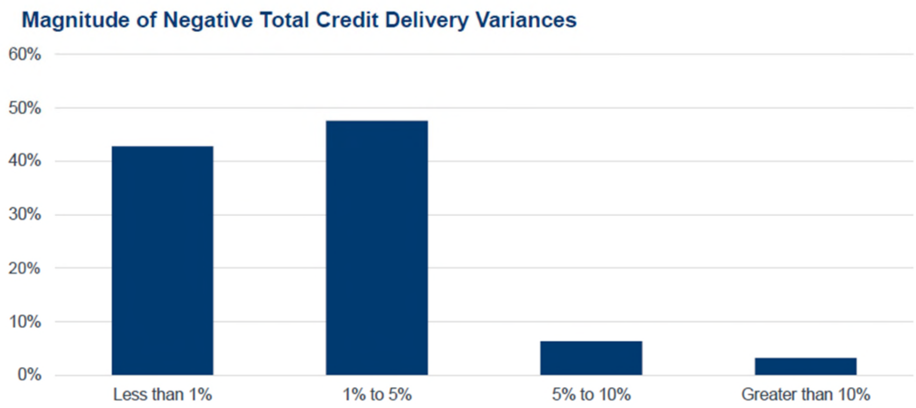


Investors have received their promised returns through housing tax credit investments

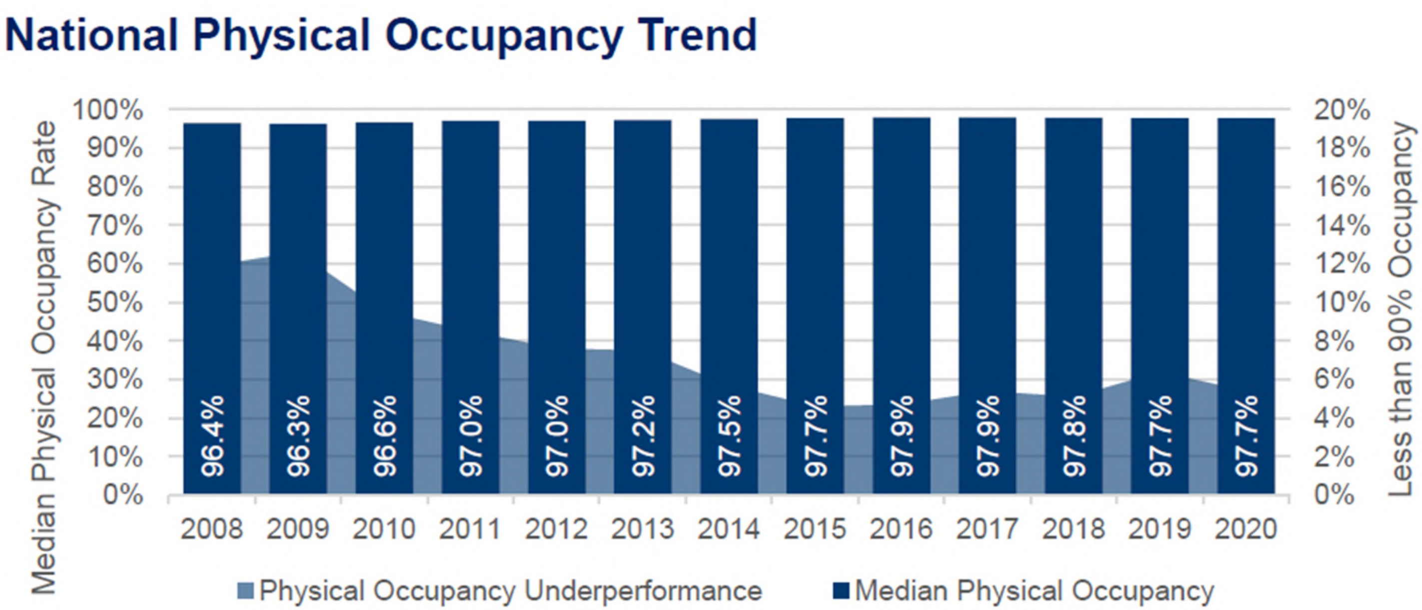
TOTAL CREDIT DELIVERY



Surveyed funds have delivered **99.5%** of the originally projected total housing tax credits



PHYSICAL OCCUPANCY

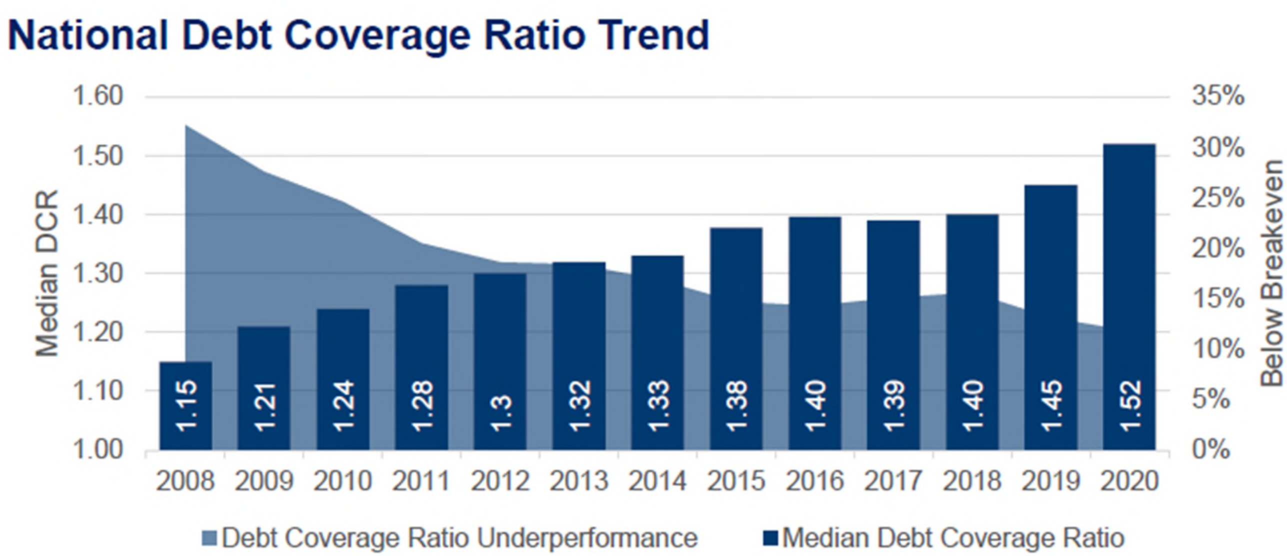


Housing tax credit properties reported a **98%** median physical occupancy rate in 2020

DEBT COVERAGE RATIO

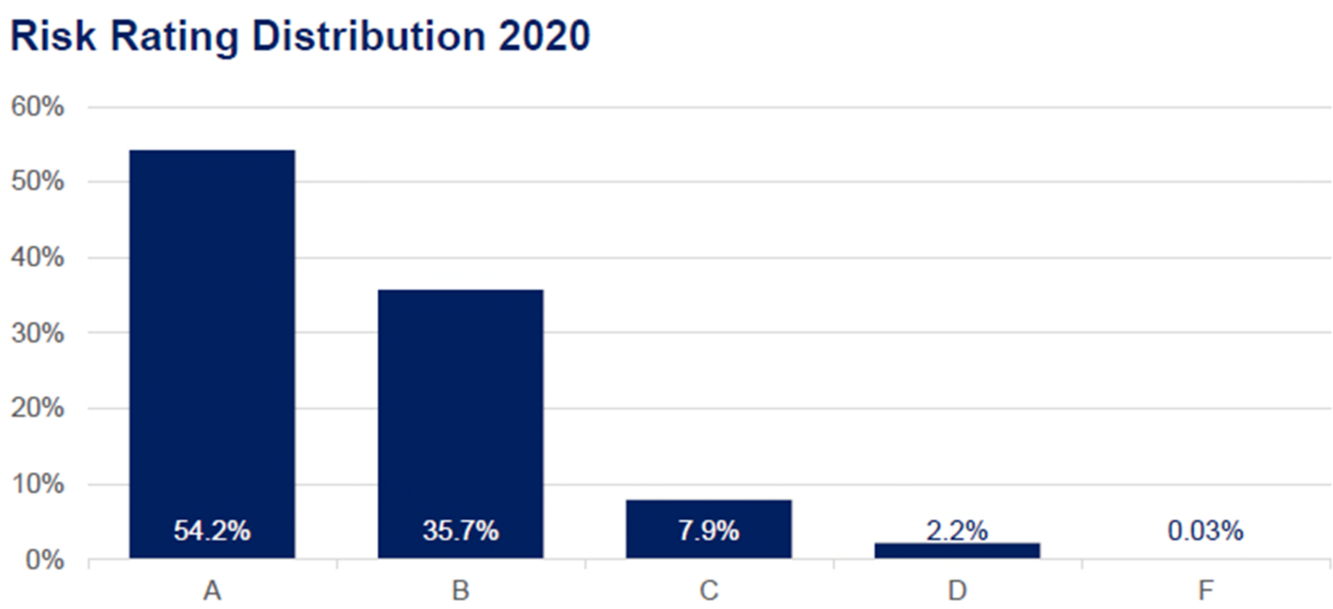
Strong financial performance trend sustained as evidenced by a 1.52 national median DCR in 2020

Less than 15% of the national portfolio operated below breakeven in 2020, significantly declined from 32% in 2008



RISK RATING

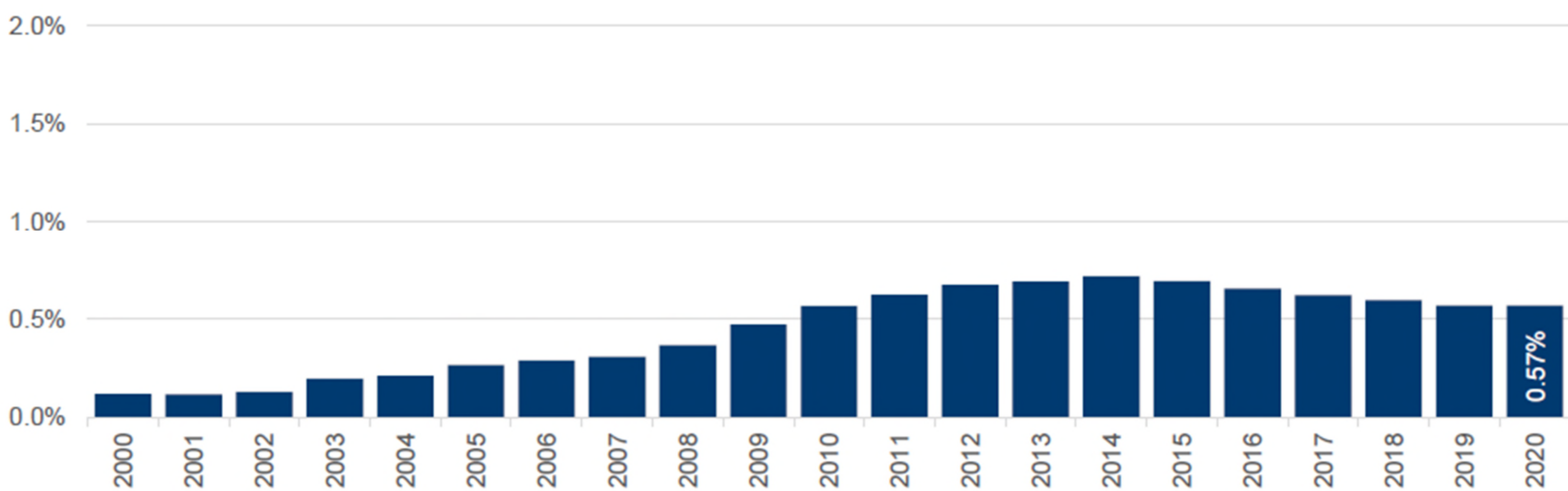
Watch list reached a historical low of under 10.5%



FORECLOSURE RATE

The cumulative foreclosure rate of 0.57% ranks tax credit properties amongst the safest real estate asset classes

Cumulative Foreclosure Rate (by property count)



CONTACT

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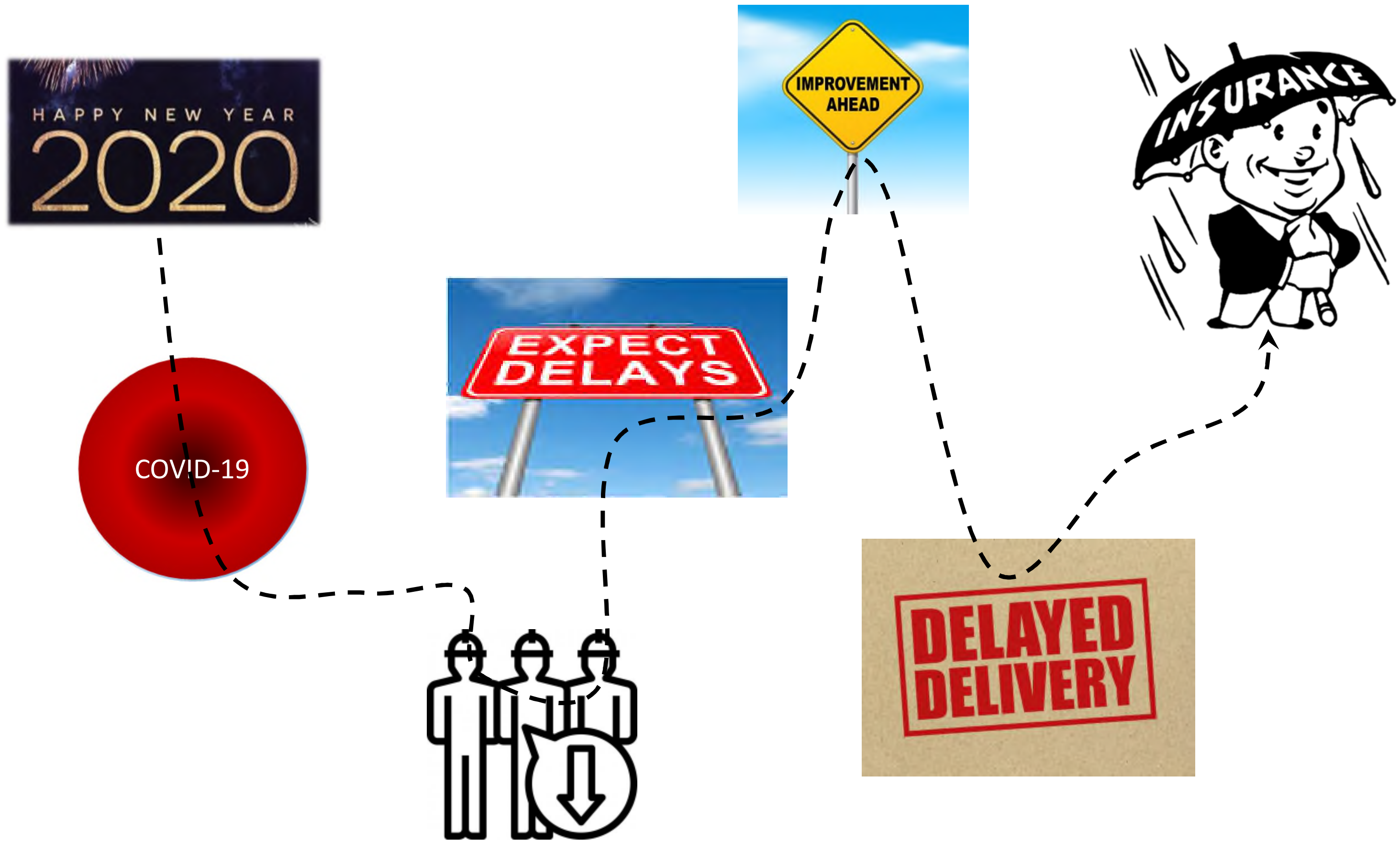
Portfolio Management & Credit: *Our 2020 – 2021 Journey*



March 2020: *COVID-19 Becomes a Reality*

Credit Responds

- Implemented changes to closing and underwriting process in anticipation of likely construction and leasing delays due to work stoppages, labor/supply issues and stay-at-home orders
- Worked closely with Portfolio Management to incorporate issues/trends in the portfolio into our front-end modeling and decision-making

Portfolio Management Responds

- Collected and reviewed COVID preparedness plans from sponsors/managers
- Commenced monthly reporting/monitoring with LPs
- Ran stress scenarios on portfolio, benchmarked status of pre-stable properties and enhanced operating reserve approval process

April – June 2020: *We Got This*

Process & Underwriting Enhancements

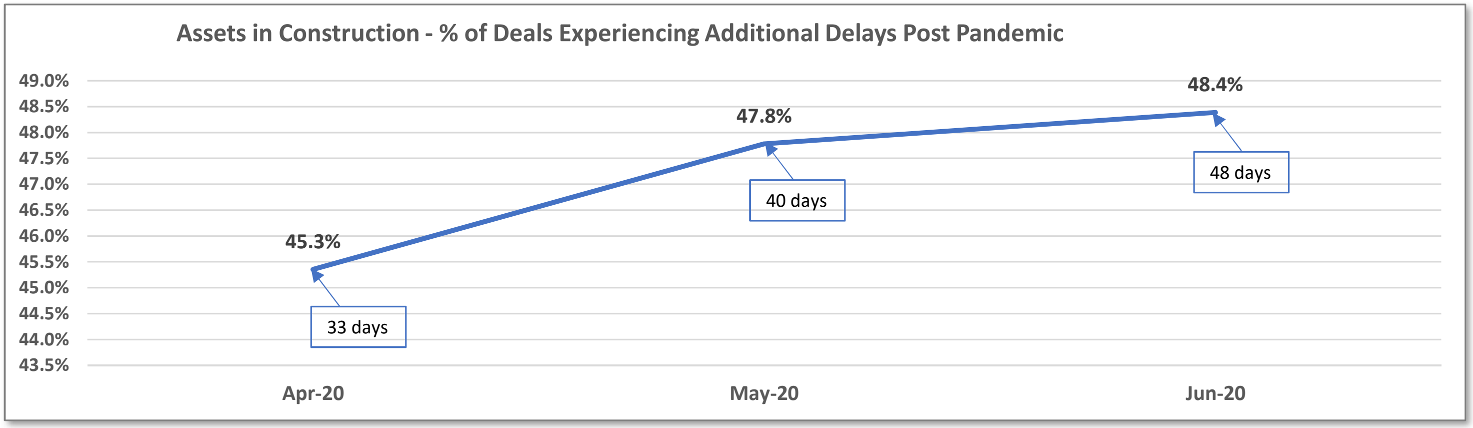
- Added a three (3) months to construction schedules as base case underwriting, or ran separate stress analysis with the same assumption
- Enhanced counterparty due diligence checklist to include updated financial statements and liquidity verifications prior to lower-tier closing
- Expanded the level of information required for all pre-stabilized properties on the guarantor REO

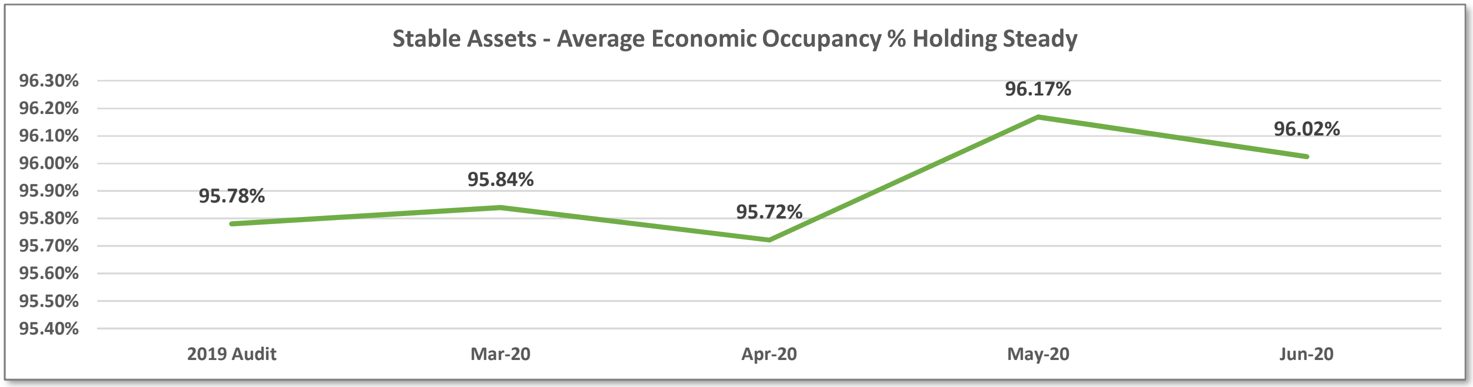
Portfolio Management Monitoring

- Initial Pre-stable trends
  - Site shut-downs, labor shortages, social distancing inefficiencies
- Initial Stable trends
  - Strong participation from sponsors/managers; average collections remained strong/steady
- CARES Act implemented

April – June 2020: *Initial Trends*

- 13 out of 94 (14%) assets experienced construction halt which lasted, on average, 27 days





July – December 2020: *The New Norm*

Credit Keeps the Pace

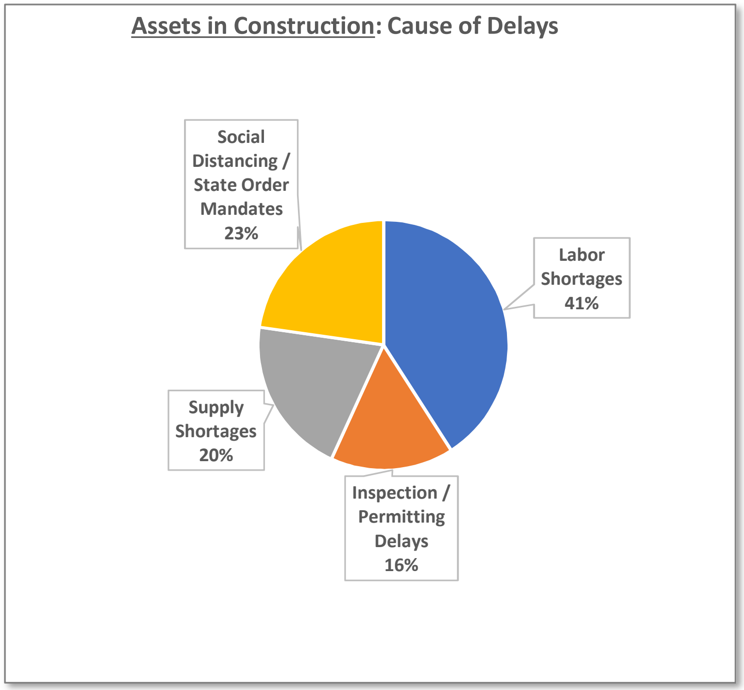
- Maintained protocols implemented in March 2020
- Continued to closely monitor impact of pandemic and applied thoughtful risk-based solutions to our modeling
- Deal write-ups were required to include COVID-19 as a risk with mitigation and stress scenarios incorporated

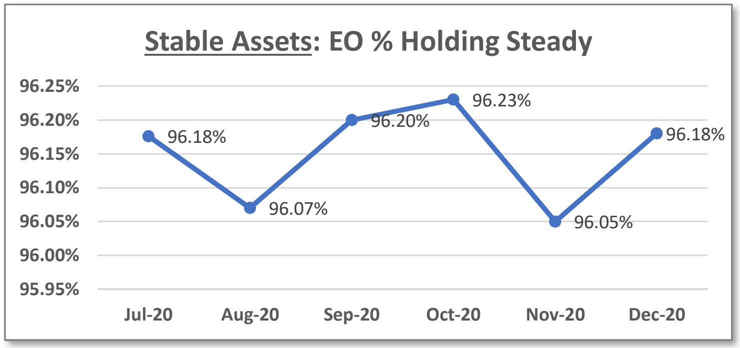
Portfolio Management-Marching On

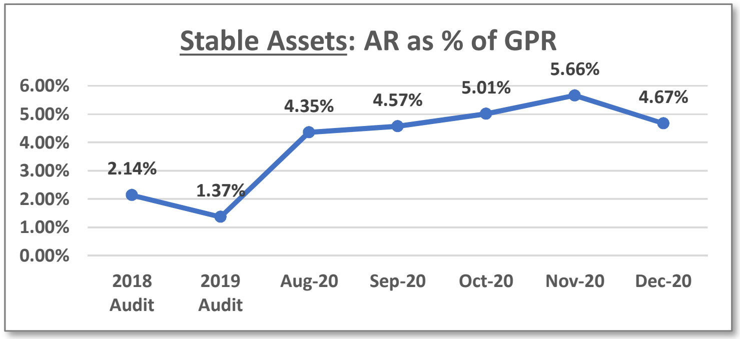
- Construction: labor shortages primary challenge throughout 2020; supply issues emerging; construction halts lifted
- Stable: Occupancy and collections hold strong (rental assistance, grants helped)
- Perm loan closings occurred, albeit at a slower pace
- Interim Site Inspection P&P implemented

July – December 2020: *Trends Emerged*

- Nearly half of assets under construction experienced additional delays, with average of 61 days as of December 2020
- Labor shortages, social distancing and state mandates primary challenges throughout 2020







January – June 2021: *New Issues, But We Still Got This*

Credit Adapts

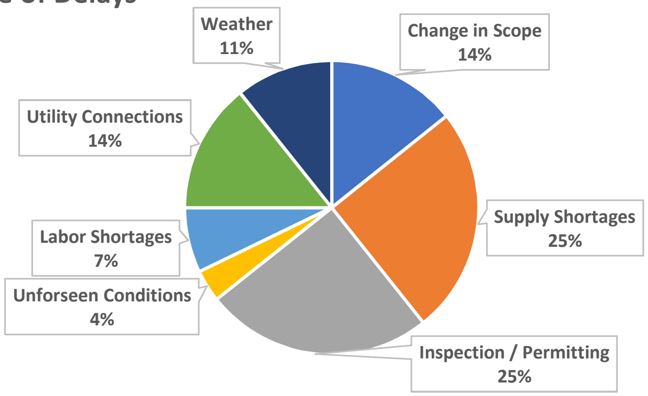
- Excuse me, lumber costs how much?
- Started asking for the percentage of the SOV that was hard bid prior to closing
- Established target of having 70% of subcontracts executed within 120 days from the start of construction

Portfolio Management Adapts

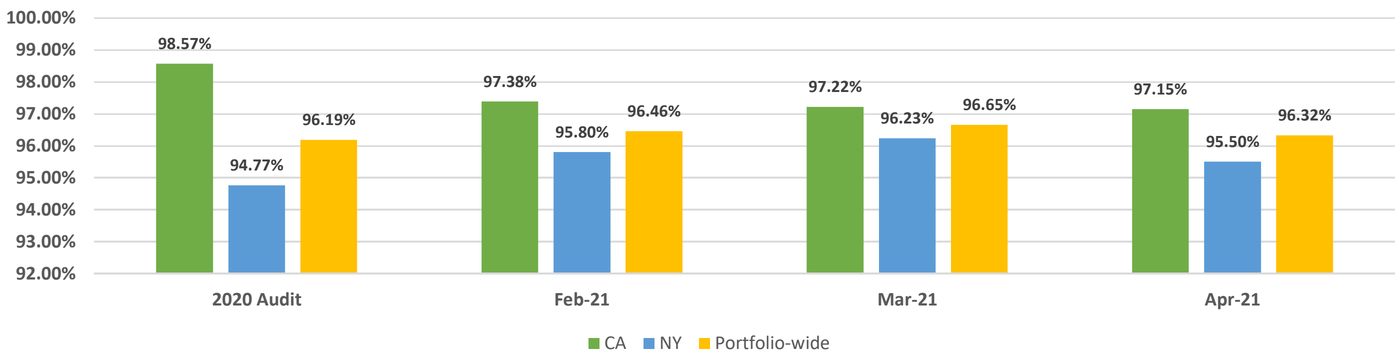
- Suspended monthly reporting
- Supply chain weakened
- Rising materials costs
- American Rescue Plan provided for further rental assistance
- IRS Notice 2021-12 aided with delayed PIS dates and credit delivery

January – June 2021: *Trends We Saw One Year In*

Assets in Construction: Cause of Delays



Stable Assets: Average EO %



July – December 2021: *Proceed With Caution*

Credit Feeling Better

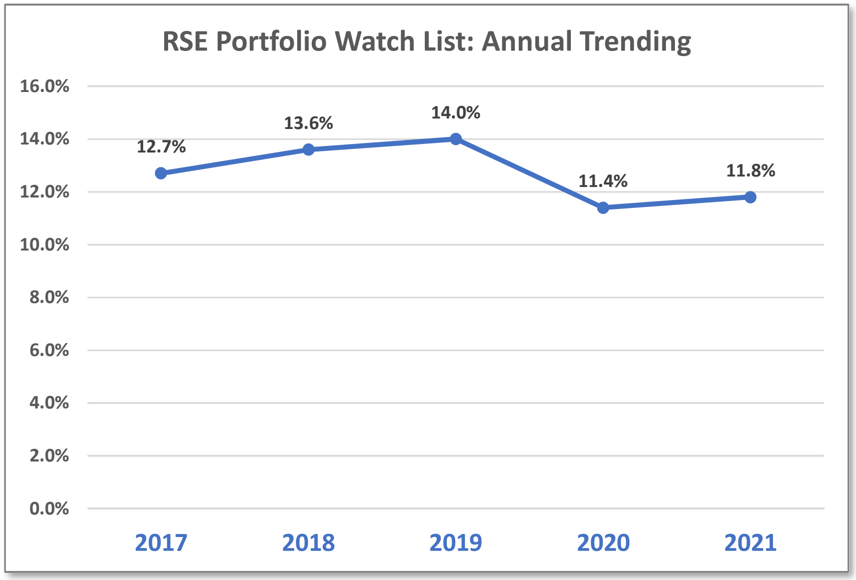
- Reduced required construction buffer from three (3) months to one (1) month
- No further changes or erosion to protocols; continued to balance enhancements and changes
- We saw stale numbers on some projects that had pushed from earlier in the year. Red Stone required updated hard bid budgets to account for continued cost escalation of materials and equipment

Portfolio Management Sees Some Light

- Usage of contingency due to rising costs
- Increase in additional soft funding requests
- Watch list percentage maintained at decreased level
- RSE-Fund 78: Closed 7/20 and 16 of 17 assets rated A and one asset rated a B as of Q4
- Approved insurance requirement exceptions

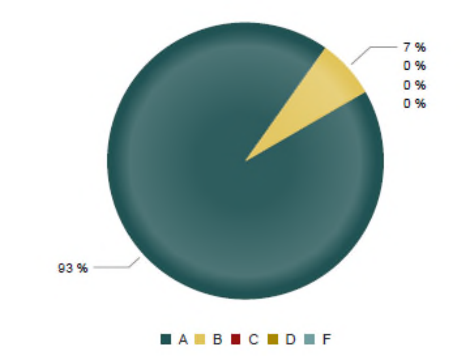
July – December 2021: *Lower Watch List Levels Maintained*

- Watch List has declined over the years and represented 11.8% of portfolio as of Q4 2021
- ***Red Stone Equity – Fund 78 LP*** closed on 7/24/2020; 16 assets are risk rated an “A”, 1 asset is risk rated a “B” and no assets have been or are currently on the Watch List



Red Stone Equity – Fund 78 LP (Q4 2021)

RISK RATING	Current Q/E	Prior Q/E
A - Excellent	93%	93%
B - Average	7%	7%
C - Watch List / Weak	0%	0%
D - Watch List / Moderate Risk	0%	0%
F - Watch List / Significant Risk	0%	0%



Where Are We Now and What to Watch

Credit: What's Next

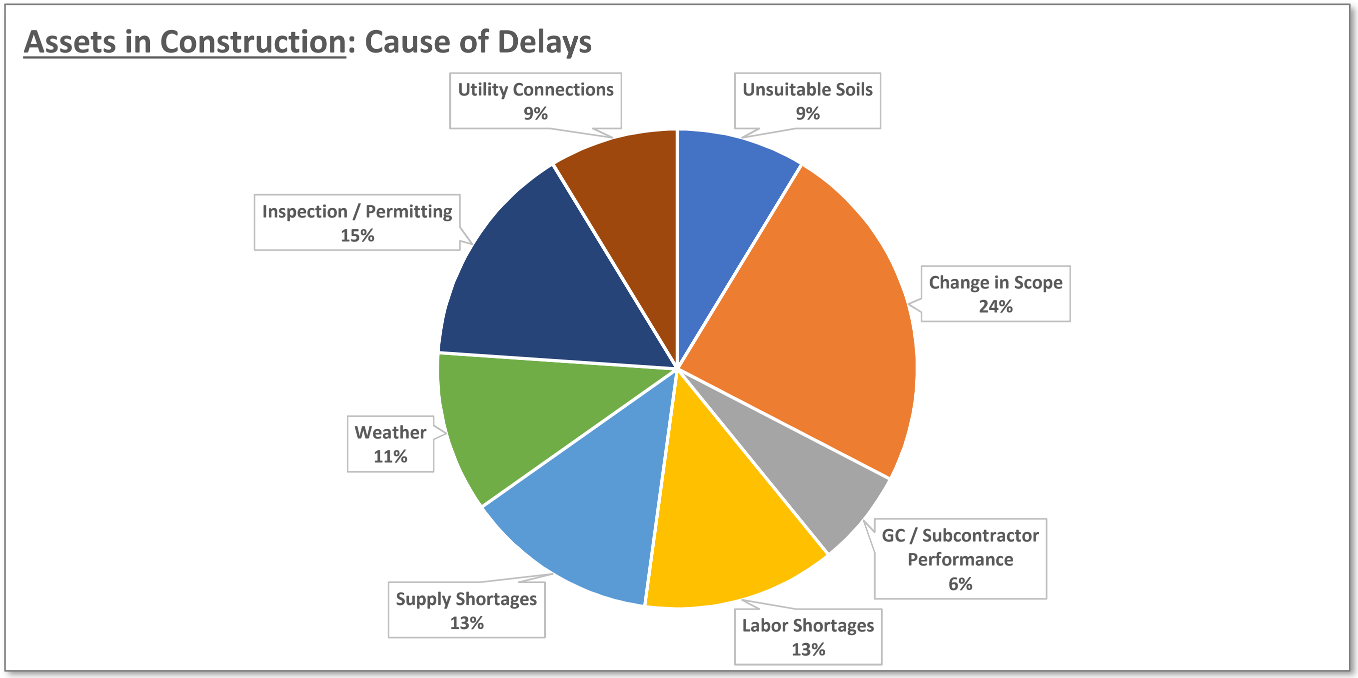
- Rising interest rates; labor/material scarcity and continued pricing volatility
- Monitoring inflation and evaluating UW assumptions (insurance expenses on rise)
- Evaluate risks associated with reduction of AMIs in 2023 and gross rent floor election
- Strong demand for affordable housing

Portfolio Management: What's Next

- Gradually reverting back to pre-COVID construction trends and have updated database to track trends
- Continuing to watch AR/bad debt as audits come in
- Watching utility expenses (seeing upward trend)
- IRS Notice 2022-05 further aided with delayed PIS dates and credit delivery
- Will be running inflation analysis on portfolio

Where Are We Now and What to Watch: *Construction*

- Labor and supply shortages continue to pose a challenge, though not as significant
- Other, more normalized issues, such as change in scope/design revisions, are starting to surface whereas COVID-related delays are beginning to lessen



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