AFFORDABLE HOUSING REPORT

Foundations for the Future

By: Ron DeVries, MAI, SRA
Senior Managing Director, IRR-Chicago

The Affordable Housing sector stands at a pivotal point, facing the dual challenge of escalating rents and development hurdles against the backdrop of increasing demand. IRR's special report highlights the integral role of the Low-Income Housing Tax Credit (LIHTC) program in funding affordable housing, set against a backdrop of intricate market dynamics and financial challenges. With the looming expiration of rent limits for numerous LIHTC-financed units, our report navigates through these complexities, providing a detailed analysis of current trends and potential future directions. Continue reading for a comprehensive exploration of the affordable housing landscape, offering clarity on its current state and exploring viable strategies for its progression.

Affordable housing comes in a variety of forms. They range from naturally occurring affordable housing (NOAH) and tenant-based rental assistance to project-based subsidies and indirect subsidies such as the low-income housing tax credit (LIHTC) program used to finance the construction and rehabilitation of multifamily units. Here, we'll focus on the role the LIHTC program plays, along with recent trends affecting development of new affordable multifamily units.

The LIHTC program uses public funding and private oversight to finance the construction and rehabilitation of such units. Under the program, each year, the IRS allocates tax credits to every state on a per capita basis. Developers compete for the credits, which are provided over a 10-year period. The credits are then sold to investors at a discounted price for each dollar awarded. Proceeds from the sale of the credits are a primary source of the development capital stack. In return for the tax benefits, which are used to fund eligible costs, developers agree to rent restrictions for a period of at least 30 years. Since the program began in 1986, under Section 42 of the IRS code, it has enabled construction of nearly 3.5 million affordable housing units.

Unlike many multifamily markets, which have experienced a run up in deliveries in recent years, the affordable housing sector remains far under-supplied. The vast majority of new LIHTC development continues to see rapid absorption fueled in part by the overall shortage of housing. The need will continue to grow: The National Multifamily Housing Council's 2022 U.S. Apartment Demand report projects a need for 4.3 million new apartments by 2035.

Equity pricing, the debt markets, and rising construction costs have created significant challenges for new development.

The National Multifamily Housing Council's 2022 U.S. Apartment Demand report projects a need for 4.3 million new apartments by 2035.

Since 2020, we've seen outsized rent growth for market rate housing. With the rise in incomes and the growth of households, affordable housing has been similarly impacted. In addition, fair market rents (FMRs), set annually by the US Department of Housing and Urban Development (HUD), increased by an average of about 12 percent for 2024. That follows a 10 percent increase in 2023. Higher FMRs increase the qualifying income limits for LIHTC housing. This, in turn, impacts rents under housing choice vouchers, which are often utilized in LIHTC developments. On the expense side, rising insurance costs are negatively impacting net income while the increase in payroll costs have slowed.

Equity pricing, the debt markets, and rising construction costs have created significant challenges for new development. After the 2016 presidential election, when corporate income tax rates were cut, demand for tax credits fell, and there was a pricing drop of about 15 percent. An additional pricing change occurred with the onset of Covid-19, due to the plunge in corporate profits. Many LOIs currently under review have been under $0.90 per credit dollar. On the debt side, the Federal Reserve has raised the federal funds rate 11 times since early 2022, pushing the 10-year treasury yield from 1.5 percent to 4.5 percent. Weakness in the banking sector has constrained funds available for commercial real estate loans. As a result, interest rates have jumped from roughly 3% to around 7%. The need for more soft debt has increased materially. The deals moving forward now are primarily limited to those that need to use their allocations before the clock for timing expires.

Construction costs for new LIHTC development have received notable media attention in some major markets. In Chicago, for example, Crain's Chicago Business reported development costs exceeding $600,000 and even $700,000 per unit for several proposed affordable projects where luxury high rises are running under $500,000 per unit. While inflation has certainly impacted hard costs, soft costs for putting these deals together continue to escalate. The ability to materially increase the supply of affordable housing continues to face many headwinds.

By 2030, reports indicate that 500,000 LIHTC-financed units will reach the end of their 30-year rent limit period. Many of these units could be viable conversions to market rate housing, reducing the supply of affordable units. Various solutions have been proposed to reduce this risk. One idea is to boost funding so more units can be delivered in the near term. Another is to have some states move to longer restriction periods. Whatever the case, it's necessary to expand economic incentives for properties nearing the end of their compliance period in order to reach HUD's goal of increased access to affordable housing.

The Valuation of affordable housing, and the nuances of the LIHTC program in particular, are significant challenges. I had the opportunity to assist in development of the Appraisal Institute's new seminar, "Fundamentals of Appraising Affordable Housing," which will be released in early 2024. I highly recommend it, if you need a basic understanding of the valuation issues associated with LIHTC properties.

SOURCES & REFERENCES

Written by: Ron DeVries, MAI, SRA, Senior Managing Director, IRR-Chicago

ABOUT VIEWPOINT

Integra Realty Resources (IRR) is one of the largest independent commercial real estate valuation and consulting firms in North America, with over 154 MAI-designated members of the Appraisal Institute among nearly 600 professionals based in our more than 50 offices throughout the United States and the Caribbean. Founded in 1999, the firm specializes in real estate appraisals, feasibility and market studies, expert testimony, and related property consulting services across all local and national markets. Our valuation and counseling services span all commercial property types and locations, from individual properties to large portfolio assignments. For more information, visit www.irr.com.

ABOUT IRR

For over 20 years, Integra Realty Resources, Inc. (IRR) has grown to become one of North America's largest independent CRE market research, valuation, and counseling firms. Our clients tell us that our nearly 600 professionals in 50+ offices deliver extraordinary insight, unbiased advice, and excellent service. In 2023, IRR valued more than $153 billion in real estate assets across more than 60 metro markets comprising more than 30,000 assignments.

Every IRR office is supervised by one of our nearly 160 MAI-designated professionals, industry leaders who have over 25 years, on average, of experience in their local markets. Having more MAI-designated experts than any other firm is just one testament to the high levels of training and experience which we put at our clients' disposal: as of January 2024, IRR's senior management team also includes: 12 FRICS; 8 MRICS; 17 CREs; 22 SRAs; 14 CCIMs; 4 ASAs.

These designations from the most prestigious real estate organizations in the world mean that from a culture of quality and ongoing professional development, we can offer unparalleled expertise in appraisals, feasibility and market studies, expert testimony, and related property consulting services across all local and national markets. IRR stands ready to serve you with unmatched Local Expertise...Nationally.