Operating Expenses, Cash Flow and Vacancy Rates

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Overview

• Operating Cost Trends
  – Data Details
  – Findings
  – Expenses, In-Depth
  – Other Observations

• AMI Trends
OPERATING COST TRENDS
Why do we care?

Initial Underwriting

Ongoing Annual Changes?

Existing Sources Weren’t Adequate
• IREM
• National Apartment Association
Leverage Ratio: Market Rate vs. LIHTC

- Market Revenue (2.4% Growth Rate)
- LIHTC Revenue (2.4% Growth Rate)
- Market OPEX (3% Growth Rate)
- LIHTC OPEX (3% Growth)
- NOI Market
- NOI LIHTC

Sources: IREM/REIS, AMI Growth Estimates, Novogradac Valuation Database
Data Source Information

AUDITED FINANCIALS

- Over 2,100 Properties
- Over 585,000 Units

Market Rate
93%

LIHTC
7%
Data Source Information

2013 data submissions... were due Oct. 31, 2014

Current dataset

Look for an update in February of 2015!
What have we found?

LIHTC Property Operating Expenses Increasing at 2.92 Percent Annual Rate

Regional Growth Rates
A look at the relative operating expense growth rates by region to region shows that operating expense trends depend on where a multifamily rental property is located.

Operating expenses in some regions grew at a faster annual rate than the national average. The fastest growth in total operating expenses between 2010 and 2012 was seen in the combined region 7, which include several Western and Midwestern states: Iowa, Kansas, Missouri, Nebraska, Colorado, Montana, North Dakota, South Dakota, Utah and Wyoming. Operating expenses in this combined region grew at an annual rate of 4.56 percent, mostly due to increases in administrative expenses and operating costs that include security, taxes and contract costs. The region with the second fastest growth rate for total operating expenses was Region 9, which encompasses Arizona, California, Hawaii and Nevada, where operating expenses for multifamily rental housing properties grew at a 3.94 percent annual growth between 2010 and 2012. This increase was caused mostly by increases in administration, payroll and management fee expenses.

Several regions’ operating expenses grew at a slower rate than the national average. Expenses in Region 4, which includes Alabama, Louisiana, New Mexico, Oklahoma and Texas, grew at 2.01 percent annually between 2010 and 2012. Multifamily rental housing properties in Region 10, which includes Alaska, Idaho, Oregon and Washington, saw operating expenses grow by 2.57 percent annually. The largest driving factor in this growth was the increase in management fees. The fifth fastest growing region was Region 4: Alabama, Florida, Georgia, Kentucky, Mississippi, North Carolina, South Carolina, Tennessee and Texas, where total operating expenses grew by 1.73 percent annually. This was primarily caused by large increases in payroll expenses and repairs and maintenance expenses, but these were tempered by a large decline in operating costs and management fees. The next fastest growing region was Region 5, which grew at an annual rate of 1.33 percent between 2010 and 2012. This region’s total operating expenses declined sharply in 2010 and recovered in 2011, accounting for much of the growth.

Total operating expenses in two regions actually declined between 2010 and 2012. Operating expenses in the combined Regions 1 and 2, which covers Connecticut, Maine, New Hampshire, Rhode Island, Massachusetts, Vermont, New Jersey and New York, experienced an annual 0.19 percent decrease. Significant variation and fluctuation within the data for these properties makes it difficult to draw a concrete conclusion about the trends of this region.
LIHTC Operating Expenses Growth is Outpacing Other Indicators

- LIHTC Operating Expenses
- "Same Store Sales" LIHTC Operating Expenses
- National Consumer Price Index
- HUD Median Family Growth
- Novogradac-Calculated National AMI Growth
- IREM Section 42 Report

2010-2012

- 2.92%
- 3.19%
- 2.61%
- 0.46%
- 2.09%
- -3.13%
Comparing Acq/Rehab Properties with New Properties

- **Total**:
  - New Construction: $4,503
  - Acq/Rehab: $4,905

- **Management Fees**:
  - New Construction: $390
  - Acq/Rehab: $434

- **Utilities**:
  - New Construction: $707
  - Acq/Rehab: $831

- **Operations**:
  - New Construction: $211
  - Acq/Rehab: $314

- **Repairs**:
  - New Construction: $646
  - Acq/Rehab: $704
Administrative Costs Per Unit
LIHTC Properties vs. Market Rate Properties

- **Market Rate Properties**
  - 2010: $565
  - 2012: $493

- **LIHTC Properties**
  - 2010: $565
  - 2012: $620

www.novoco.com/products
LIHTC Property Operating Expenses
Slightly Decline as the Size of the Property Grows

- 50 units: $4,937.22
- 100 units: $4,880.39
- 200 units: $4,768.68
- 300 units: $4,659.54
- 400 units: $4,561.89
- 500 units: $4,468.49

Thousands

Number of Units
LIHTC Property Administrative Expenses
Also Slightly Decline as the Size of the Property Grows

- 50 units: $709.46
- 100 units: $665.63
- 200 units: $585.93
- 300 units: $515.78
Benchmarking of Portfolios or Individual Assets

Forensic Analysis for Understanding Situations that are Below Expectations

Underwriting Support

Scenario Analysis When Planning Renovations

Planning For Year 15 Dispositions and/or Partnership Transfers
"LIHTC Property Operating Expenses Increasing at 2.92 Percent Annual Rate"
buff.ly/1Ir1QUA #LIHTC
What is AMI?
### AMI Trends (2014)

<table>
<thead>
<tr>
<th>Region</th>
<th>AMI 3 Year Growth</th>
<th>AMI 6 Year Growth</th>
<th>VLI 3 Year Growth</th>
<th>VLI 6 Year Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>West</td>
<td>0.748%</td>
<td>1.874%</td>
<td>0.748%</td>
<td>1.874%</td>
</tr>
<tr>
<td>Midwest</td>
<td>1.115%</td>
<td>2.012%</td>
<td>1.115%</td>
<td>2.012%</td>
</tr>
<tr>
<td>Northeast</td>
<td>0.275%</td>
<td>1.599%</td>
<td>0.275%</td>
<td>1.599%</td>
</tr>
<tr>
<td>South</td>
<td>0.991%</td>
<td>1.601%</td>
<td>0.991%</td>
<td>1.601%</td>
</tr>
</tbody>
</table>
When will AMI increase?
AMI Recovery Time
Based on Income Growth Projections

Baseline for Recovery Calculation

-5%

2013

2014

Affects 5% of the country

No recovery time
<1 Year
1-2 Years
2-3 Years
3-4 Years
4-5 Years
5+ Years

Existing Projects Held Harmless
HUD Published for New Projects
Actual VLI
(Not published by HUD)
Where is my AMI?
2015 AMI Limits

• Changes to legislation will delay the release of 2015 Income Limits until February 2015
  – H.R. 3547 – Consolidated Appropriations Act of 2014 (Sec 238)
  – Income ceilings for Extremely Low Income (30% AMI) has a floor based on Poverty guidelines set by Health and Human Services in addition to existing Extremely Low Income standards set by HUD
Over 450 counties nationwide will have their 30% AMI adjusted upward.

Has larger effect on Section 8 programs and LIHTC in states where 30% deep targeting is tied directly to HUD-published 30%

This will most likely push back released of all income limits to February for all future years due to the timing of HHS’s Poverty Guideline release.
We Can Help Predict AMI!

- AMI is based on Census data and Trend Factors which are available well in advance of HUD’s release of the income limits
- Assuming HUD does not change its methodology:
  - We can predict up to two-years out by predicting HUD Trend Factor
  - We can accurately model one-year out using all published factors
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