IMPACT® COMMUNITY CAPITAL

MARKET COMMENTARY

Q4:2025

Tax-Exempt Income Through Affordable Housing Solutions

Tax-Exempt Income That's Anything but Boring

Mention municipal bonds in a café near Wall Street and you'll likely get eye rolls or polite, suppressed yawns. For most, "tax-exempt" is associated with low yields and low excitement — the opposite of the kind of story that goes viral on LinkedIn. That perception leaves some attractive areas of the market completely ignored by taxable institutional investors.

One such strategy focuses on a part of the market that investors are increasingly captivated by: affordable housing. Tax-exempt income from securitized Low Income Housing Tax Credit (LIHTC) mortgage pools may sound like a hyper-niche market, but it has qualities that appeal to a broader set of investors than many realize. The investment is relatively straightforward. First, you aggregate a diversified portfolio of tax-exempt LIHTC mortgages. Next, you securitize that pool of mortgages. The senior bonds are sold, allowing for the return of capital, while the B-piece, or most subordinate tranche, is retained.

Here is where things get more interesting: the B-tranche, which can have a duration exceeding 15 years, produces federally tax-exempt income that, when appropriately structured, has the potential to offer double-digit yields. Think about that on a tax-equivalent basis.

A New Approach Based on Long-Standing Legislation

For nearly 40 years, virtually all rent-restricted affordable multifamily housing supply has been generated through the LIHTC program, which was introduced in the Tax Reform Act of 1986. The program provides tax credits to owners and developers who then sell these credits to investors to raise equity for their properties. Since the tax credits are usually not sufficient to cover all building costs, LIHTC mortgages have also been around for a long time. For example, IMPACT Community Capital (IMPACT) has been originating, managing, and structuring LIHTC mortgages for over 25 years.

Borrowers are motivated to stay current on the mortgage or risk losing or having their tax credits clawed back. That serves as a strong deterrent against default. And it's partially why LIHTC loans have demonstrated lower default rates versus conventional multifamily debt for decades. Another reason is that this type of housing generally includes subsidies from local, state, and federal programs that provide an additional cushion for credit risk.

The other driving force is basic ECON 101: supply and demand. The National Low Income Housing Coalition reports that the United States has a shortage of 7.1 million affordable and available rental homes . On the supply side, the average number of total affordable units produced annually through the LIHTC program over the last five years has been under 150 thousand units . At the current rate of production, it will take decades for supply to even catch up with demand.

The need also continues regardless of where we are in the economic cycle. In times of growth, with rising incomes there is increasing demand for affordable housing. Conversely, during downturns, job and income losses further exacerbate the need for affordable rents. This acyclical nature, especially when combined with the long-term supply limitations, has historically resulted in high occupancies, stable cash flows, and low default rates.

Given these dynamics, it's not surprising that LIHTC debt has pretty much been the domain of "smart money" since inception.

Even Broader Appeal

While municipal bonds have long been the cornerstone of tax-exempt investing, their yields are rarely attractive to a broader range of investors searching for higher yields. There is a time-tested solution that IMPACT pioneered over 25 years ago, securitization. That is, taking the tax-exempt LIHTC mortgage loans, packaging them into a portfolio, and then securitizing them to create an alternative source of high-quality, tax-exempt income with double-digit yield potential. These structures combine the credit stability and social impact of affordable housing with the efficiency and transparency of more traditional asset backed securities – offering taxable investors a differentiated, higher yielding alternative to traditional munis without sacrificing credit discipline.

Filling the Income Gap

The obvious question is, "If this is the case, why don't I see this strategy everywhere?" The short answer is that while the concept behind this strategy is simple, the underlying instruments are quite complex, and there are high barriers to entry. Very few managers are entrenched enough to do it well. Affordable housing debt — particularly tax-exempt LIHTC mortgages — is a structurally intricate, operationally intensive niche that has remained neglected among private capital due to the specialized sourcing, compliance, and regulatory expertise required.

In a market where esoteric ABS strategies are gaining renewed interest for their 'esotericism' and municipal bonds remain a bore, securitized tax-exempt LIHTC mortgages can fill the gap.

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[1]National Low Housing Coalition. The GAP: A Shortage of Affordable Homes. March 2025.
[2]National Council of State Housing Agencies 2024 State HFA Factbook. "Affordable" defined as multifamily units restricted to residents with incomes at 80% or less of area median income.

Photo credit: https://prosperahcs.org/portfolio-posts/palms-at-blucher-apartments/

Q3 2025 INVESTING HIGHLIGHTS

While concerns about the health of the economy eased somewhat, deal activity remained modest in the second quarter. In Q3, IMPACT helped finance 478 units of affordable housing through new commitments and purchases totaling $24.39 million. Examples of such deals are found below:

478 Units
of affordable housing financed in Q3 2025

SPOTLIGHT PROPERTY: RAYMOND E. SHEPHARD HOUSE

- **Address:** 503 E. 9 Mile Road, 410 Vester St., & 414 Vester St., Ferndale, MI 48220
- **Property Description:** The Raymond E. Shepherd House is a new construction 53-unit development located in Ferndale, MI. This project is designed to support families from moderate to low-income backgrounds affected by recent expansion in the luxury housing sector and aims to provide stable housing for adults within the community to age in place. The property offers social services through the support of Community Housing Network (CHN), a non-profit organization based in Troy, MI. The on-site services include employment, education and financial support, case management, and health and wellness services.
- **AMI Restrictions:** All units are restricted to households at or below 60% AMI
- **Sponsor:** Full Circle Communities, Inc.
- **Governmental Support:** $1,000,000 Oakland County HOME Loan, $700,000 Environment, Great Lakes, and Energy loan
- **Amenities:** Designated community amenity space, fitness room, computer room supportive service space, electric car charging, bike storage, and secure access control
- **IMPACT Financing:** $2,312,500 MM Taxable Loan
- **Originator:** Bank of America

Photo credit: https://www.fccommunities.org/rsh/

SPOTLIGHT PROPERTY: WHITTIER COMMONS

- **Address:** 2609 Blaisdell Ave, South Minneapolis, MN 55408
- **Property Description:** Whitter Community Housing is a recently-completed 85-unit multifamily development in Minneapolis. The property contains both new construction and rehabilitation components; the existing building was originally built in 1903 for use as a school and was converted to multi-family housing in the 1970s. The project is designed to serve families, with eight units specifically allocated for those who have experienced homelessness. Residents will benefit from an on-site service coordinator; on-site services include health and wellness classes, educational support, and service coordination.
- **AMI Restrictions:** 85 Units at 30%-50% AMI
- **Sponsor:** CommonBond Communities
- **Governmental Support:** $2,388,800 from the Minnesota Housing Finance Agency (multiple programs), $3,000,000 from Hennepin County, and $3,857,000 from the City of Minneapolis (multiple programs)
- **Amenities:** Common laundry room, community room, on-site management, computer room, elevators, playground, controlled security access, high speed internet
- **IMPACT Financing:** $6,129,000 MM Tax-Exempt Loan
- **Originator:** Wells Fargo

Photo credit: https://whittier.propertyss.com/

ADDITIONAL IMPACT UPDATES:

IMPACT released its 2025 Impact Report, "More Than a Roof: Where Housing Meets Opportunity," highlighting how our investments offer more than housing – they help residents thrive through specialized services such as senior care, education support, and employment assistance. Read the full impact report here.

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