WNC PRESERVATION EQUITY FUND 2

INVESTMENT THESIS

ANSWERING AMERICA'S HOUSING CRISIS BY PRESERVING AFFORDABLE HOUSING

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CONTENTS

AFFORDABLE RENTAL HOUSING DEFINITIONS

- *Area Median Income (AMI)* – Median family income in the metropolitan or non-metro area
- *Affordable Housing* – Housing with rents capped at 30% of low-income household AMI
- *Cost Burdened* – Households spending more than 30% of their income on housing costs
- *Severely Cost Burdened* – Households spending more than 50% of their income on housing costs
- *Low-Income* – As defined by HUD, households with incomes at or below 80% of AMI
- *Low Income Housing Tax Credit (LIHTC)* – Program established by Congress in 1986 that allocates federal tax credits over a 10-year period to corporations that invest in newly constructed and rehabilitated affordable rental housing
- *Workforce Housing* – Housing for those earning between 80% and 120% of AMI (limited to 25% of PEF's investments)

1 | EXECUTIVE SUMMARY

America is facing a housing affordability crisis. Millions of families, senior citizens, and veterans are struggling to keep a roof over their head while paying as much as 50% or more of their income in rent. Meanwhile, millions of affordable communities are being lost to demolition and conversion to market rate apartments, luxury condominiums and other commercial buildings.

WNC & Associates, Inc. ("WNC") believes investing in existing, affordable rental communities offers investors the opportunity to have a positive social impact while acquiring an asset class with a) stable income, b) the potential for appreciation, and c) a strong hedge against recession.*

In this context, WNC is launching Preservation Equity Fund 2, L.P. ("PEF") which seeks to:

- Provide quarterly cash flow distributions and capital appreciation to taxable, non-taxable, impact and Community Reinvestment Act ("CRA") investors.*
- Acquire existing, affordable apartment communities including HUD and LIHTC properties after the credit period where all or a portion of the units are restricted to rents that are affordable to residents at 80% or less of AMI.
- Target high cost-burdened markets where strong barriers to entry exist and where the discount of affordable rents to market rents is 20% or more. Such a variance provides a strong hedge during recessionary times when market rents tend to fall yet still cannot compete for tenants.
- Focus on assets that are functional at the time of acquisition, address any deferred maintenance and capital expenditures without over improving the assets (general limit $5,000 per unit).
- Focus on correcting any operating inefficiencies while maintaining the affordable component of each asset.
- Execute an exit strategy in 5-7 years that preserves the affordability of each community through a sale to a new owner seeking to re-syndicate the property using new LIHTCs; or sell to third party committed to the long-term affordability of housing.

WNC – ESTABLISHED 1971

WNC has specialized in affordable rental housing investments for 48 years. We have a highly experienced team lead by senior executives that average 18 years with the company and 22 years in the real estate industry. During this time, we have:

- Focused exclusively on affordable rental housing.
- Raised $5 billion in equity on behalf of 100+ institutional investors.
- Acquired 1,400 properties in 47 states.
- Developed a research based, proprietary analytical platform that ranks competitive market areas for affordable housing investments based on key economic and industry specific metrics.
- Built a diversified team of professionals with expertise in project sourcing, underwriting, asset and fund management, data analytics, and development.

* *There can be no assurances of any level of returns. All investments have a risk of loss.*

2

WHY INVEST IN AFFORDABLE RENTAL HOUSING?

"Risk comes from not knowing what you are doing"
– Warren Buffet

At WNC, it is our belief that safe, clean and affordable rental housing is not only a stable asset class, it is fundamental to the well-being of our communities and the US economy. Nonetheless, affordable rental communities are often misunderstood, usually when contrasted to traditional market rate apartments. While newer, Class A apartments might well constitute the core of an institutional investor's portfolio, affordable housing has many advantages over Class A apartments that translate to a host of investor benefits. These include:

Affordable Housing Characteristics		Investor Benefits
Regulatory Complexity	➔	High Barrier to Entry/Less Competition
Higher Cap Rates	➔	Higher Cash-on-Cash Returns
Discount to Market Rents	➔	Hedge Against Recession
Lower Vacancy Rates	➔	Lower Turnover and Related Costs
Durable Rents	➔	Predictable Income
Preserving Affordable Homes	➔	Positive Social Impact

BARRIERS TO ENTRY

To invest successfully in affordable rental housing requires experience working in a complex regulatory environment. Unlike market rate apartments, affordable rental properties typically must comply with federal, state and/ or local regulations that can impact many aspects of a property's ownership and operations. Rent restrictions, tenant income requirements, utilities, dispositions, transfers of interest, refinancing, distributions and a host of other aspects can all be subject to regulation.

This regulatory environment takes years to master and serves as a significant barrier to entry to traditional real estate investors, owners and developers. Because WNC has specialized in the investment and asset management of affordable rental housing for 48 years, acquiring over 1,400 properties in 47 states, we are experts in these regulations and use these complexities as a competitive advantage.

CASH-ON-CASH RETURNS

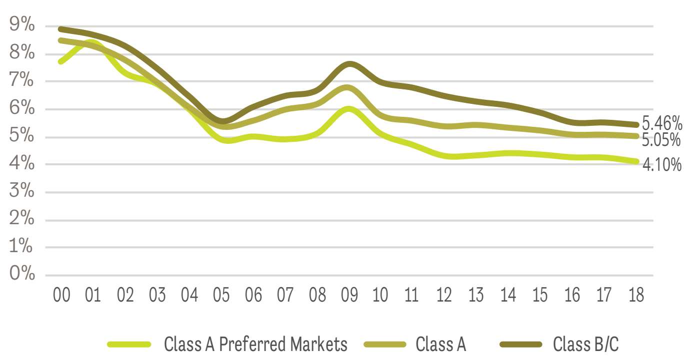
Due to the regulatory restrictions associated with them, affordable properties warrant higher cap rates in most markets. Depending on the market and asset quality, the premium can range anywhere from 50-150 basis points over market-rate assets. While difficult to filter out cap rates for just affordable properties, Exhibit 1 illustrates the spread in cap rates between Class A and B/C assets, the latter of which includes affordable properties.

While higher cap rates are usually associated with higher risk in the multifamily space, it's actually not the case with affordable rental housing. The higher spread accounts for the greater complexity and expertise needed to operate the properties.

Exhibit 1

Cap Rate Spreads

Class A and B/C Assets



When partnering with sponsors well versed in this regulatory complexity such as WNC, investors benefit from higher cash-on-cash returns while bearing the same, if not lower, risk profile as with market-rate properties.*

RECESSION HEDGE

WNC/PEF is targeting high cost-burdened markets where there is a material variance between affordable rents and market rents. High cost-burdened markets have a built-in buffer during recessionary times, particularly where the variance between affordable rents and market rents is 20% or more. This benchmark provides a buffer during recessionary times because when market rents fall, which they tend to do during recessions, they still remain higher than affordable rents in high cost-burdened markets.

Because our tenants are tenants by necessity, versus tenants by choice who generally chose market-rate units, affordable rental properties tend to stay full and their incomes remain steady, even during recessionary times. These high cost-burdened markets are also vulnerable to loss of affordable housing stock, and investment in these areas is crucial to preserving these assets.

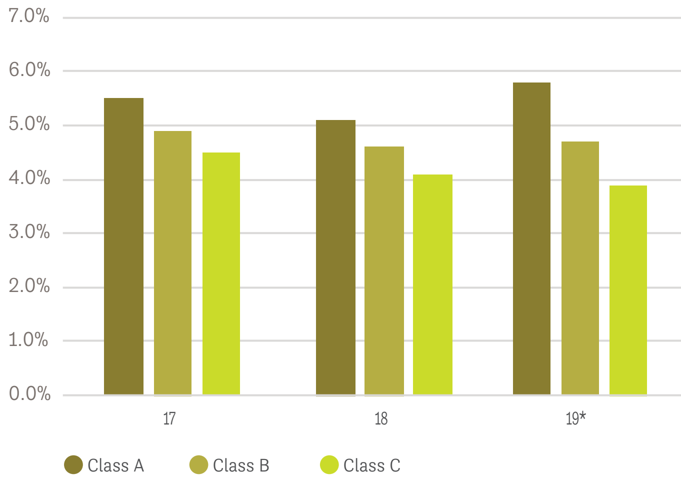
LOWER TURNOVER AND RELATED COSTS

Due to the significant need and short supply, affordable rental properties tend to have significant waiting lists, particularly in high cost markets. Consequently, vacancy and turnover rates tend to be much lower in affordable communities compared to market-rate assets and the apartment inventory as a whole. This provides steady revenue streams while limiting turnover and associated costs. Exhibit 2 on the next page illustrates the difference in vacancy rates by asset class. Again, data is not available specifically for affordable properties but they are generally categorized as Class C assets.

* *There can be no assurances of any level of returns. All investments have a risk of loss.*

Exhibit 2

U.S. Apartment Vacancy by Asset Class



Source: Marcus and Millichap Research Services

Even though the turnover rate for all apartments is at a 20-year low, it still hovers near 50% [2] as compared to WNC's portfolio turnover which averages under 20%.

PREDICTABLE INCOME

In general, rent growth in the affordable rental space is tied to area median income (AMI), and in the larger metropolitans, AMIs have been growing in the mid-to-high single digits.[3] Since AMI is a composite of the last 3-years of incomes, short-term projections are easily predicted and expected to remain strong.

Additionally, the Housing and Economic Recovery Act of 2008 established a law that prevents rents in many affordable communities from falling during economic recessions. The law essentially protects properties built before 2008 from falling rents and thus limits downside risk as well as volatility.

3

PEF INVESTMENT STRATEGY

WNC's knowledge and experience in affordable rental housing has revealed a multitude of opportunities to create value in the sector. PEF's investment guidelines are based on a broader strategy to apply our underwriting knowledge and proprietary research to source and close on the most compelling assets in the most compelling markets. We do this by:

- Targeting high cost-burdened markets characterized by large variances between affordable and market rents and strong economic indicators.
- Acquiring physically sound assets including HUD and LIHTC properties (that have completed the 10-year credit period) that are underperforming economically due to inefficient operations.
- Appointing professional property management that has a track record working with WNC/PEF and experience growing rents and managing expenses.
- Closely monitoring operations of the assets with an eye toward keeping rents at affordable limits based on AMIs and correcting any operating inefficiencies.
- Investing in assets with low to moderate capital needs and implementing capital expenditure plans that focus on preserving the physical condition of the asset.

STRUCTURAL INEFFICIENCIES

The LIHTC program allocates federal tax credits to investors over a 10-year period. Following this phase, benefits to investors are generally limited to tax deductions from depreciation and amortization. PEF seeks to invest in LIHTC properties after the ten-year credit period is completed and all the tax credits have been allocated to the LIHTC investor.

Due to structural inefficiencies explained below, LIHTC operators are not focused on maximizing cash flow or asset value, which creates the opportunity PEF is focused on in its acquisition strategy.

One of the distinctions of affordable rental housing, particularly LIHTC housing, when compared to market rate housing, is the lack of structural incentives to drive cash flow or build long term residual value through capital appreciation.

- Over the last 30 years, most affordable housing transactions were financed using LIHTC.

- The primary benefit to investors in LIHTC are tax benefits consisting of federal tax credits and passive losses from depreciation and mortgage interest deductions.

- LIHTC investors do not expect cash flow distributions or residual proceeds.

- LIHTC properties are underwritten by investors and lenders to perform slightly above breakeven.

- Increasing cash flow at LIHTC properties can actually lower investor returns because cash flow lowers tax losses (investors are allocated tax losses but not cash flow).

Developer incentives, similarly, are driven by the tax credits. Developers receive cash fees of up to 15% of the total development cost of the project. These fees, along with construction costs, are paid in part from proceeds received from selling the tax credits to investors. Developer fees are paid in cash when construction or rehab has been completed and the properties are leased up.

- Given the large amount of tax incentives associated with LIHTC projects, both investors and developers tend not to focus on traditional real estate metrics that drive cash flow and residual value.

- Consequently, a vast number of tax credit properties underperform compared to their potential with regard to rent growth, operating efficiencies, NOI growth, and overall net cash flow and capital appreciation.

FOCUS ON RENTS

While rents under the LIHTC program are capped per a formula tied to the Area Median Income (AMI), they are set by the owner/operators who can raise or lower rents as long as the rents remain at or below the AMI limits.

- When the AMI in a given community rises, it is permissible for the operator to raise rents accordingly (rents do not have to be lowered if AMI goes down). [4]

- WNC refers to the highest allowable rent at LIHTC properties as “net max rent” which is the lessor of maximum allowable rent based on the AMI restriction or market rent.

- Rents at most LIHTC properties are capped at 50% and 60% of AMI (well below market) and generally include a mixture of floor plans set at different levels.

Because LIHTC operators typically do not focus on rent or NOI growth, they are not always diligent about charging allowable net max rents, or even increasing rents when AMI rises. This is a lost opportunity because, in most high cost housing markets, it is not unusual to see LIHTC units renting for 20%, 30% or even 40% below market rents with large waiting lists. By paying such a large discount to market rents, tenants are rarely willing to vacate a LIHTC unit due to rental increases.

- PEF maintains that adjusting rents at LIHTC communities when AMI rises and maintaining rents as allowable under the LIHTC program contributes to healthy capital expenditures and reserves which in turn allows the owner to maintain safe, clean and affordable housing for the residents.

FOCUS ON OPERATING EXPENSES

As in the discussion on rents above, operating expenses are another area where inefficiencies exist with owner/operators in the affordable rental market.

- WNC/PEF’s experience is that many affordable/LIHTC operators are not incentivized or focused on minimizing operating costs beyond what is necessary to maintain debt coverage ratios required in loan documents and/or limited partnership agreements.

- In many cases, property owner/developers have their own in-house property management company and charge fees higher than market. To these operators, operating costs and cash flow take a back seat to tenant income certification and overall regulatory compliance.

- With an extensive evaluation of operating budgets and an eye toward operating efficiencies that can be gained, PEF expects to pursue cost savings initiatives that will have a significant positive impact on NOI, cash flow and overall property valuation.

- As part of these cost saving initiatives, PEF will consider energy efficiency programs which can create more sustainable communities and provide significant savings in water, electricity, sewer and trash utility costs.

TARGET ASSETS

PEF's primary target is apartments with all or a portion of units restricted to rents that are affordable to tenants at 80% or less of AMI. This allows for self-selection of assets in the preservation space that don't compete with value-add or opportunistic buyers. Ideally, PEF acquires assets with near-term (5-15 years) expiring restrictions that allows us time to plan the right exit that preserves the affordability. Targeted assets include properties:

- Developed/financed by the Low-Income Housing Tax Credit Program that have completed their 10-year credit period.

- Receiving Section 8 Housing Assistance Payment contracts.

- Financed with redevelopment bonds, and other supportive housing programs.

- Located in job-centric locations with access to public transportation and neighborhood amenities.

PEF may also invest in workforce housing (limited to 25% of PEF's investment portfolio) which includes properties with all or a portion of units restricted to rents affordable to families and individuals between 80% and 120% of area median income.

While naturally occurring affordable housing properties (those without a regulatory agreement but with affordable rents serving households at 80% or less of AMI) can fall into the workforce housing definition either in whole or part of the property, it is not the primary focus but rather an option should a compelling opportunity present itself. WNC's objective is to keep the properties affordable to the renter at 80% AMI or below.

TARGET MARKETS

WNC has developed a proprietary analytics platform that will rank competitive market areas for affordable housing investments based on economic and industry-specific metrics. The ranking selection is based upon factors that include but are not limited to:

- Variances between market rent and affordable rent.

- Economic indicators showing strong income, job, and population growth.

- Real estate fundamentals, housing supply and steady rent growth.

- Housing characteristics such as locations with high-propensity to rent.

This proprietary analytics platform is designed to identify and prioritize the markets that will yield strong cash flows and steady appreciation.

CAPITAL NEEDS

Affordable housing investment requires a fine balance of infusing capital to address the physical needs of the asset while still returning yields within the confinements of rent restrictions. WNC's strategy is to target functional assets with low- to moderate-capital needs and budget for deferred maintenance and capital expenditures. In general, the fund will target assets requiring no more than $5,000 per unit in capital expenditures, unless compelling reasons justify more. The purpose should be to preserve the asset's physical condition and keep it in conformity, if not better condition, to its surrounding neighborhood while minimizing resident impact and cash flow disruption.

SOCIAL SERVICES AND SUSTAINABLE PROGRAMS

The social impact objective of PEF goes beyond simply preserving affordable housing. At WNC, we believe responsible ownership includes providing resident services that enhance quality of life at our properties. Regulatory agreements that are in place at many affordable rental communities typically require services to remain in-place for only 10 years, after which they can be eliminated. PEF intends to keep social services and evaluate all programs for need and usage in order to provide the programs that best improve the quality of life for the residents while in line with the budget.

Additionally, environmentally sustainable programs will be evaluated to improve energy efficiency. These include installing low flow plumbing fixtures and LED lighting, implementing recycling programs, reducing paper marketing materials, and selecting sustainable and environmental materials when possible. The programs will benchmark utility usage and calculate ROIs with expected payback between 2 and 2.5 years. These services, green initiatives, and light to moderate physical upgrades will not only enhance the communities overall but contribute to their long-term stability.

4 | WNC – SPONSOR PROFILE

WNC is a privately held company under the same family ownership since its founding in 1971. WNC's 100 employees include dedicated, multidisciplined teams lead by a senior management group that averages 18 years with the company and 22 years in the real estate industry.

Over the course of the last 48 years, WNC has:

- Focused exclusively on affordable rental housing which remains its core business and passion.
- Raised $5 billion of equity on behalf of 100+ institutional investors including global insurance companies, international and regional banks, manufacturing and utility companies.
- Acquired 1,400 properties in 47 states and 196 MSAs across the country.
- Established a strong track of institutional funds that have met or exceeded, on average, originally projected returns from tax credits including more than 75 LIHTC funds and 13 New Market Tax Credit funds.
- As of January 2020, fully invested PEF 1 (Fund 1), which is on track to exceed original return projections due to improved cash flow stemming from revenue gains and operational efficiencies, as well as asset appreciation.

PROPERTY ORIGINATION AND UNDERWRITING

WNC is a specialist in affordable housing in every sense of the word. We've built a national platform with proven property origination and underwriting teams necessary to deploy capital on a large scale. These teams, which include 18 professionals based in 6 states across the US, originate and close over $400 million of equity annually in affordable housing. Our experience in acquiring 1,400+ assets and relationships with more than 400 principals/owners across the country gives us direct access to LIHTC and other affordable rental properties that are potential acquisitions for PEF.

ASSET MANAGEMENT

WNC's Asset Management group includes 21 professionals with experts in financial analysis, construction asset management, housing compliance, partnership taxation and stabilized asset management. PEF has a dedicated asset management team that is supported by WNC's financial analysts and housing compliance professionals.

FUND MANAGEMENT

The Fund Management group consists of seven professionals and is responsible for analyzing and tracking PEF yields, overseeing cash distributions and investor capital calls, providing quarterly and annual investor reporting, and conducting annual valuations of the portfolio to determine valuations. The team also handles investor inquiries and maintains a web-based investor portal that allows investors to view and download fund specific and consolidated reports of their holdings.

DEDICATED DATA MANAGEMENT AND ANALYST TEAM

WNC has developed a proprietary data management system, Essential Property Information Quantified (“EPIQ”), that is a cloud-based data warehouse that tracks PEF asset and portfolio performance. The system provides asset managers with critical, real-time financial and operating data, including graphic interface comparing revenue and expense details of PEF assets with comparable assets in the market. EPIQ data is analyzed by a team of financial analysts who are tracking property operations and reporting on a monthly, quarterly and annual basis.

IN-HOUSE DEVELOPMENT TEAM

Community Preservation Partners (“CPP”), WNC’s subsidiary and in-house tax credit development team, specializes in the preservation of affordable rental properties undergoing substantial rehab. CPP has served as fee developer, co-developer and sole developer in 9 states.

As a full-service development company, this team includes 16 professionals with expertise in project sourcing, LIHTC and HUD project structuring and feasibility, construction/project management, and asset and portfolio management. CPP has developed and co-developed over 100 tax credit properties representing 8,800 units and more than $2 billion in development cost. CPP, which acquires properties for its own account on both coasts, has deep broker relationships and works closely with PEF in sourcing projects for the fund.

5

ADDENDUM: THE AFFORDABLE RENTAL HOUSING LANDSCAPE

On July 15, 1949, the Housing Act of 1949 was signed into law which set forth the ambitious goal of a "decent home and a suitable living environment for every American." Despite this lofty goal, America is facing a housing affordability crisis today. Millions of families, senior citizens, and veterans struggle to keep a roof over their head because they cannot afford their rent. Yet in communities across the nation, rents continue to rise while incomes of many renters remain stagnate. Perhaps the most visible symptom of this affordability crisis is homelessness, which has become a growing problem in communities across the nation.

The federal government has tried its hand at addressing this housing crises, including through programs such as the low-income housing tax credit (LIHTC), HUD Section 8 Rental Assistance and housing choice vouchers which have provided much needed incentives to develop, own and operate rental housing that is affordable. However, funding levels for these programs have remained well below that needed to adequately address the challenge.

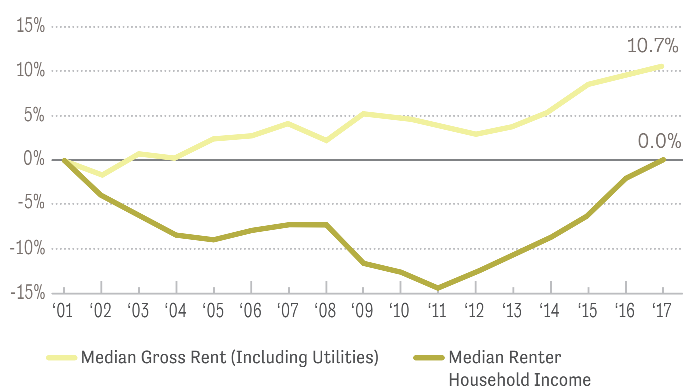
GROWING DEMAND

Renter households make up a large percentage of American society. More Americans – a total of 43.3 million households – are renting now than any time in the last 50 years.[5] These include our nation's senior citizens, working families, professionals, veterans and students.

Exhibit 3

Renters' Incomes Haven't Caught Up with Housing Costs

Percent Change Since 2001, Adjusted for Inflation



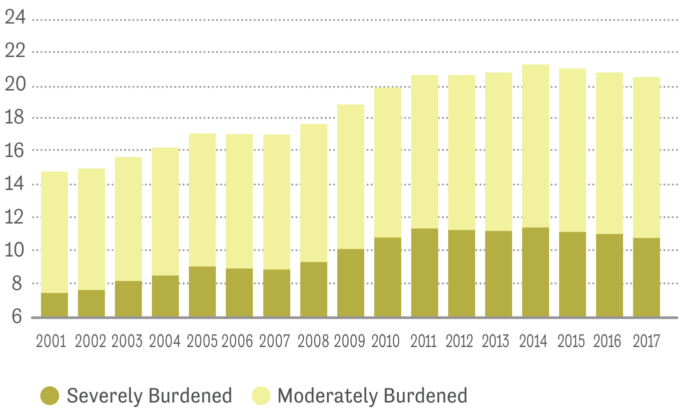
Source: CBPP tabulations of the Census Bureau's American Community Survey.

Adapted from The Center on Budget and Policy Priorities, retrieved from http://www.bibme.org/citation-guide/apa/website/

Exhibit 4

. . .The Number of Cost-Burdened Renters Remains Close to Peak Levels

Renters with Cost Burdens (Millions)

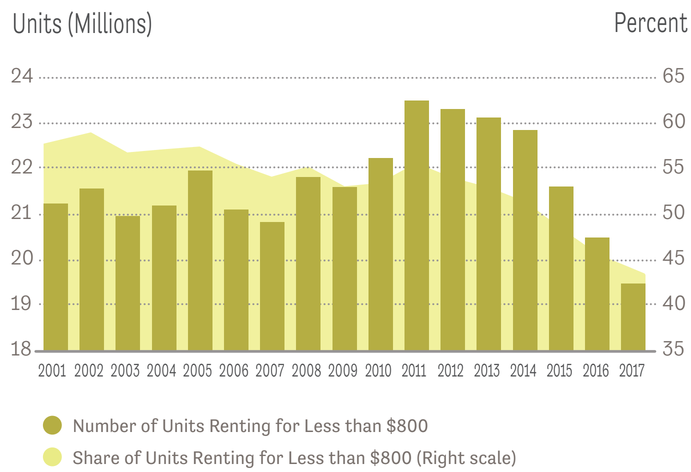


Notes: Cost-burdened (severely cost-burdened) households pay more than 30% (more than 50%) of income for housing. Households with zero or negative income are assumed to have burdens, while households paying no cash rent are assumed to be without burdens.
Source: JCHS tabulations of US Census Bureau, American Community Survey 1-Year Estimates.

Adapted from *The State of the Nation's Housing 2019*, Joint Center for Housing Studies of Harvard University, 2019, Figure 32, p. 32.

Exhibit 5

The Low-Rent Stock Has Shrunk by Four Million Units Since 2011



Notes: Contract rents are adjusted to 2017 dollars using the CPI-U for All Items Less Shelter.
Source: JCHS tabulations of US Census Bureau, American Community Survey 1-Year Estimates.

Adapted from *The State of the Nation's Housing 2019*, Joint Center for Housing Studies of Harvard University, 2019, Figure 3, p. 4.

The median household income of all renters is $38,944, or roughly 65% of the median income of all households in the United States. As shown in Exhibit 3 on the previous page, when compared to rental housing costs, which have risen more than 10% between 2001 and 2017, renters' incomes have continued to lag. While renters' incomes on the whole have risen since the great recession, they have only gained back what they lost since 2001 after adjusting for inflation.[6]

The lower a resident is on the income scale, the greater the risk that resident is going to struggle with the cost of housing. With stagnate incomes and housing costs on the rise, more and more Americans are considered cost burdened and struggling to keep up with the rising cost of housing.

Cost burdened renters are those households that are spending more than 30% of the income on housing costs. In the United States, the number of cost-burdened renter households stood at 20.5 million in 2018 (see Exhibit 4). This represents 47.4% of all renters and is 5.7 million (27.8%) more than the number of cost-burdened households in 2001.[7]

Also shown in Exhibit 4, these cost burdened renters make up a large section of the workforce and include medical assistants, teacher assistants, office and accounting clerks, customer service reps, retail service managers and a host of other participants in the workplace.[8] A total of 10.7 million of these renter households are severely housing cost burdened, which means they are paying more than 50% of their incomes in rent.

To emphasize this point, a family with one full-time worker earning the minimum wage cannot afford the local fair-market rent for a two-bedroom apartment anywhere in the United States.[9]

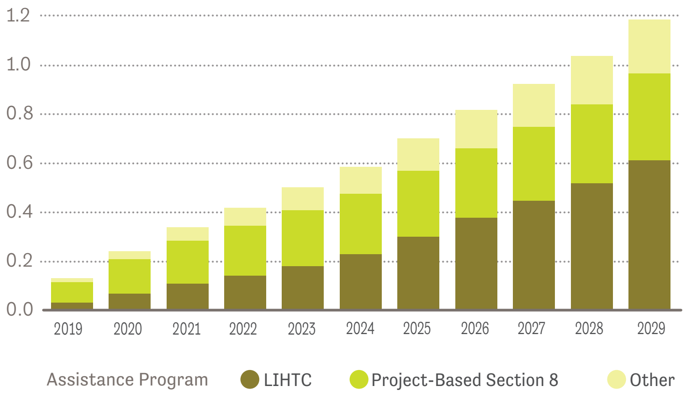
SHRINKING SUPPLY

While demand for affordable rental homes is on the rise, the supply of this basic necessity continues to shrink. According to the 2019 State of the Nation's Housing by the Joint Center for Housing Studies of Harvard University (JCHS), the supply of affordable units (units renting for less than $800 and affordable to those making $32,000 or less) has fallen every year since 2011. As shown on Exhibit 5, a total of 4 million

Exhibit 6

Affordability Restrictions on Nearly 1.2 Million Rental Units Are Set to Expire by 2029

Cumulative Units with Expiring Affordability Period (Millions)



Notes: Data include properties with active subsidies as of January 1, 2019. Other includes units funded by HOME Rental Assistance, FHA Insurance, Section 236 Insurance, Section 202 Direct Loans, USDA Section 515 Rural Rental Housing Loans, and units in properties with more than one subsidy type expiring on the same day. Estimates for properties with multiple subsidies with different expiration dates are conservative. The NHPD does not account for state incentives to extend affordability restrictions or for potential early departures from the programs.
Source: JCHS tabulations of Public and Affordable Housing Research Corporation and National Low Income Housing Coalition, National Housing Preservation Database.

Adapted from *The State of the Nation's Housing 2019*, Joint Center for Housing Studies of Harvard University, 2019, Figure 35, p. 34.

units, or 17% of total affordable rental housing stock, were removed from the nation's housing inventory during this time.

Nearly 5 million assisted affordable units have been developed over the past 40 years through the LIHTC program, HUD rental assistance programs and various federal grants, mortgage insurance and interest rate subsidies. In general, these programs service tenants earning no more than 60 percent of AMI by restricting the rents or subsidizing rents the tenants pay. Most of the restrictions and subsidies have expired or are soon to expire. As shown in Exhibit 6, 1.2 million units with affordability restrictions are set to expire by 2029.

The demand-supply imbalance for low-income households is undeniable and unfortunately has no immediate relief despite the many well-intentioned policies. Growth forecasts predict new renters will exceed that of new homeowners over the next 25 years, creating additional competition for apartments which will likely further increase pressure on rents.

RISING COSTS AND REGULATORY BURDENS

A major factor contributing to the dwindling supply of affordable communities is that the existing stock is being replaced with more expensive market rate apartments, luxury condos and other commercial properties. This is due to a confluence of factors, including:

- Rising construction costs.
- Growing regulatory burdens.
- Challenges affordable housing developments face in local communities.

Construction costs have increased 21% between 2008 and 2016, far outpacing inflation.[10]

The growing regulatory cost to construct housing is another key contributor to the barriers of developing affordable housing. According to a 2018 study by the National Association of Home Builders (NAHB), 32.1% of the cost to build an apartment, on average, is linked to regulations imposed by local, state and federal government. In some areas such costs account for 42%. Regulatory costs can include building permit fees, utility hook-up fees, guarantee fees and impact fees.

The burden of addressing local opposition to the development of affordable housing, otherwise known as "not in my backyard" (NIMBY) groups, is an additional cost that often goes unreported. Such groups have become exceedingly vocal against new affordable housing communities and often contribute to costly delays if not outright prohibition of affordable housing developments.

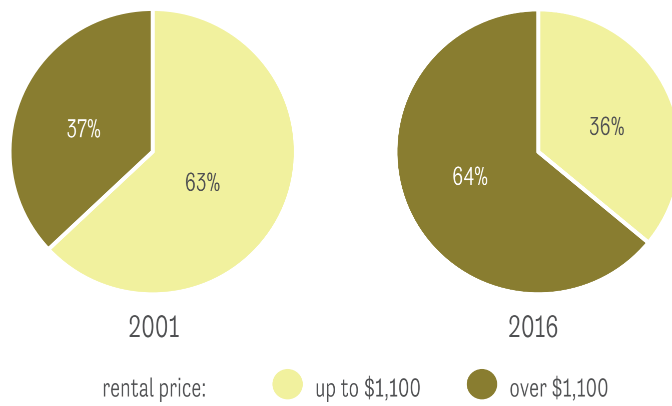
Higher costs cut into and/or eliminate the smaller profit margins associated with the development of affordable housing. Multifamily developers, not surprisingly, have turned almost exclusively to building luxury apartments to afford the increased costs and regulatory burdens. In fact, 80% of new units in the largest metropolitan areas are aimed at the luxury market[11] which means that new construction has become increasingly less affordable to low-income renters.

As shown in Exhibit 7:

- The share of new housing stock renting above $1,100 has increased from 37% in 2001 to 64% in 2016, while the share of new stock renting below $1,100 per month declined from 63% in 2001 to 36% in 2016.

Exhibit 7

Composition of New Rental Stock 2001 vs. 2016



Source: American Community Survey, 1-year estimates

With soaring construction costs, increased land use regulations and local opposition to affordable rental housing, new apartment supply is expected to continue targeting high rents.

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EXHIBIT A: PEF INVESTMENT GUIDELINES

A. The general asset profile

1. Existing, stable apartment communities targeting tenants making 80% or less of median income.
2. Existing subsidy in place such as federal LIHTC, HUD Housing Assistance Payment (HAP) contract and other subsidies.
3. 50+ unit communities.
4. $5+ million transaction size.
5. Cap ex needs addressing deferred maintenance and minor cosmetic improvements, preferably less than $5,000 per unit but no higher than $10,000 per unit.

B. Market Criteria

1. Material Affordability Gaps – weighted average 20% + discount to market.
2. Healthy Area Median Income (AMI) trends.
3. Wage and employment growth.
4. Diverse demographics.
5. Higher barriers to entry and oncoming new supply of <3.0% of existing stock each year.
6. Stable communities.

C. Financing Criteria

1. DCR – 1.15 or greater. DCR in affordable housing is by nature less stressed during downturns due to predictability of below market rents and sustainable occupancies.
2. Standard guidelines for Fannie Mae and Freddie Mac.
3. Commercial debt leverage below 75% on portfolio.
4. Fixed rate or cap on variable rates.
5. Ideally match the debt with the estimated hold period plus an additional 2 years with early pre-pay options to allow for flexibility in exit; however, each term and structure will be evaluated deal by deal.

D. Affordable Criteria

1. In-place rent restrictions (deed restricted or loan restricted).
2. Target tenants at or below 80% of AMI which can include naturally affordable housing.

E. Exit Strategy

1. Re-syndication.
   i. Sell to new owner/partnership applying for new LIHTC allocation/ other subsidies.
   ii. Appraisal or market-based valuation.
   iii. New partnership commits to rehab plus additional 30 -50 years of affordability.
   iv. Prioritize WNC existing developer relationships (400 + partners nationwide).
2. Sale to third party.
   i. Market / appraisal based valuation.
   ii. Commitment to maintain affordability in perpetuity.
3. Put/Call to GP structured to achieve targeted IRR & preferred return.