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Opportunities in Year 15

IPED's Learn the Basics: Housing Tax Credits 101

NIXON PEABODY NOVOGRADAC IPED

Our Speakers

Opportunities in Year 15

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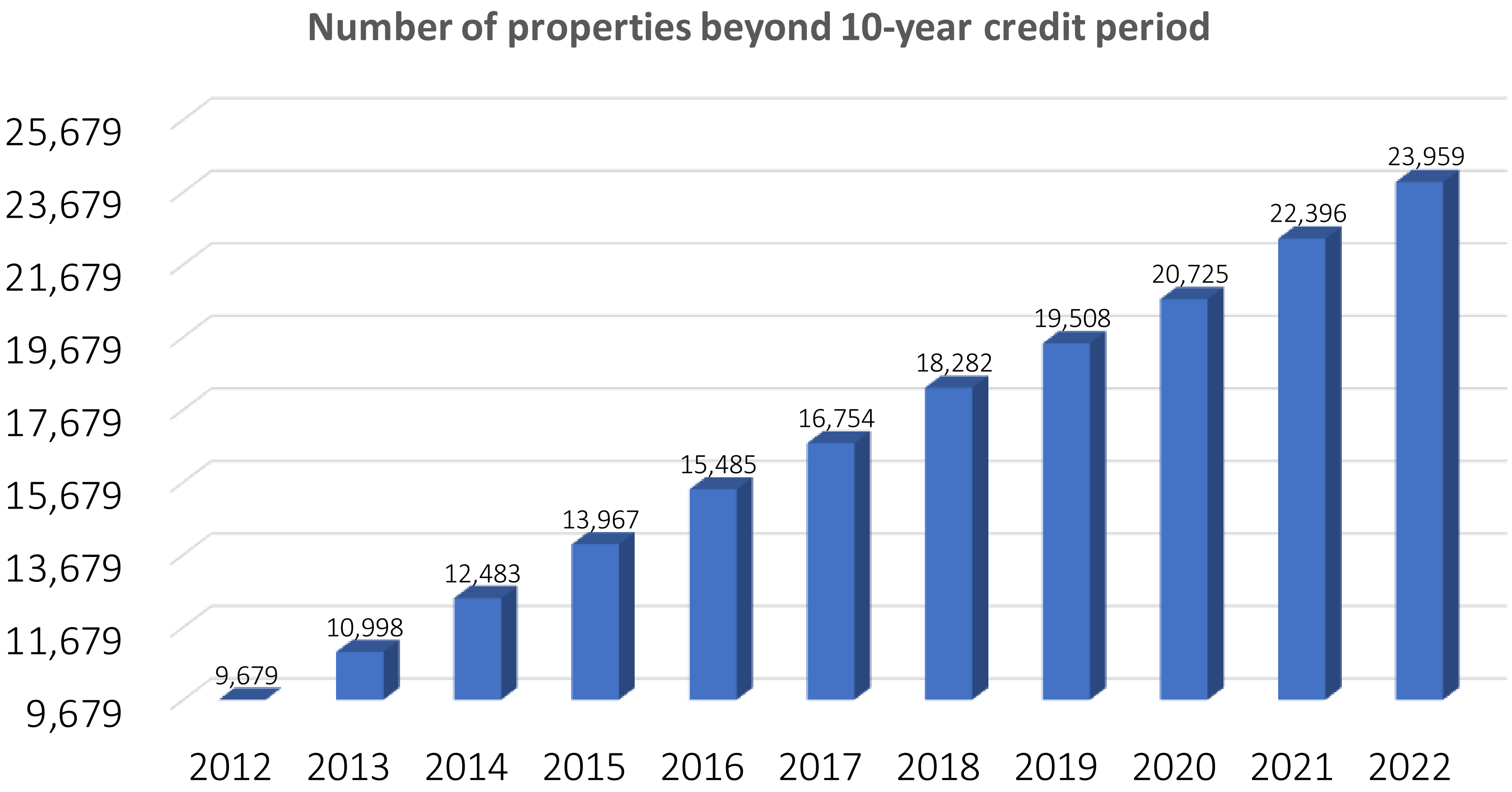

Number of properties beyond 10-year credit period
25,679
23,679
21,679
19,679
17,679
15,679
13,679
11,679
9,679
9,679
10,998
12,483
13,967
15,485
16,754
18,282
19,508
20,725
22,396
23,959
2012
2013
2014
2015
2016
2017
2018
2019
2020
2021
2022

Key Questions

Transactions

/ What are the Year 15 provisions and how do they work

/ Common perspectives of today’s buyers and sellers?

/ Financing strategies and sources being used?

/ Can deals get done before Year 15

“What’s your exit strategy?”

Typical Year 15 Transactions

- GP buys LP interest
- Refinancing
- Sale

- Recapitalization with new round of tax credits or other financing
- Qualified Contract Process

- Recapture Guarantee
- Put and Call

Financing Strategies and Sources

Markets Change:

2021

- Low interest rates high values = refi opportunities to buy out partners.
- Markets flooded with low-cost LIHTC friendly equity and debt for recapitalization.
- Result: many options for Y-15 refi, recapitalization, property or Pship sale or LIHTC recycle.

2024

- High interest rates = few refi opportunities to cash in Property equity for partners.
- LIHTC pricing has not kept up w increased debt and construction costs. GAP funding needed. 4% deals don’t work well w/o soft funds.
- Fannie/Freddie vs. FHA Loans
- Some owners and LPs missed opportunities to cash out of mature deals.
- Previous exit strategies such as Bridge Loan to FHA perm don’t work now.
- More soft debt to close LIHTC deals means Less equity to owners in Y-15.

3rd Party Property Buyers…Market Changing

2021

- Affordable and market rate buyers bullish on high occupancy and rent growth.
- LIHTC Developers looking to build a pipeline of properties for future LIHTC syndications.
- Private equity partnerships or individuals like leveraged returns with 3% 30 year loans.
- CRA-motivated buyers for LIHTC equity.
- San Antonio year 15 LIHTC deals sold for sub 4 cap.

2024

- Cap rates are up, property prices down, Transaction volume significantly slower.
- Lender standards tightening LTV down, Fewer Interest only loan options.
- Buyers much more conservative in underwriting.
- Bridge loans, Interest Only and high leverage loans are starting to default.
- ‘Extend and pretend’ for now, some Lenders now out of the market.
- Some LIHTC developers lack liquidity. Off market sales of GP interests to raise cash.

3rd Party Buyer Perspectives

Third-party buyer incentives:

- 2024 cash on cash yield expectations higher.
- REPLACEMENT cost is a huge incentive for buyers. New construction/development costs up significantly, therefore older properties have a competitive cost advantage.
- Plans to improve revenue through renovation and repositioning are more conservative, (a discipline enforced by lenders and investors).
- Expense growth not 3%, Labor up, insurance cost increases is an unknown. $2000 PU ?
- Buyers rarely anticipating an immediate Qualified Contract Price or market rate conversion.
- However, 30 year Extended Use properties are available for long term hold buyers to convert to market.

GP and LP Perspectives

Existing GPs—buying the LP’s interest:

- Maintain existing cash distribution and fees
- Benefit from LP’s losses
- Resyndication opportunity

LP wants a timely exit after Year 15:

- LIHTC benefits have been delivered
- Tax losses of limited value
- No recapture risk (post YR15)
- Investors are keenly aware of residual value
- Market sale best determinant of value

How to Achieve a Successful Exit

GP and LP Perspectives

- / Start the process early and communicate often; understand the goals of your partner
  - Surprises = Delays
- / Understand the Partnership Agreement. What are the GP’s and LP’s rights
- / Maturing Debt, Lockouts, and Prepayment Penalties, Unpaid Development Fees.
- / The *&^% BOV as a valuation tool

How to Achieve a Successful Exit

GP and LP Perspectives

- Tax Consequences – Consult the Partnership's Accountant
  - Capital Accounts – Impact on Splits vs. Partnership Agreement Waterfall. When is the Waterfall not a Waterfall ? Upon dissolution..
- Impact on value of HAP Contract, Limited Distributions, Regulatory Agreements, and other Subsidies
- Documents…Words matter…Read each one.
  - The 32M (a) in the Right of First Refusal
  - The 860K word 'First" in the waterfall language

Value of LIHTC Property at (or near) Year 15

- Purpose of Valuation – Review Partnership Agreement
  - Dissolution of Partnership
  - Buyout of Interest (GP, LP)
  - Partnership Agreement Valuation Stipulations – Who, What, How

Value of LIHTC Property at (or near) Year 15

Internal Property Valuation

Problems – GP & LP value may be substantially different

Many partnership agreements require an independent appraisal

Market Value – Underlying Real Estate Asset First

More supportable for legal proceedings

Unbiased third party opinion of value, subject to the scope of work

Value of LIHTC Property at (or near) Year 15

How do you Value at Year 15?

- Market Value – assuming continued affordability restrictions
- Market Value – assuming Market Rate (hypothetical)
- Market Value – assuming 3 year conversion from affordable to market rate (Qualified Contract – voids LURA)

Components to Real Estate Value

Potential Gross Income

- Are existing rents (ie contract rents) too high/low compared to market?
- Read LURA closely – what AMI levels restricted for 15 years – LURA post 15 years may not be as deeply income targeted
- Are there any specifications in the partnership as to how income is handled?
- Voucher Income?

Vacancy

- How are other properties in the area performing?

Operating Expenses

- Compare to both historical and comps (includes Replacement Reserves)

Capitalization Rate

- Should be based on current sales activity in the market

Cautions

- Differences in value between investment value and fair market value.

Issues to Consider

Abatement or PILOT termination.

Impact of reassessment on sale.

Cash flow restrictions per regulatory Agreement.

Changing liability insurance requirements.

Immediate repairs/capital needs.

What scenario is being valued per scope of work, investment value vs. Fair Market Value, (restricted vs unrestricted?

Mark up or down to market of HAP Contract.

New potential sources of income (wireless/offline commercial, etc). Is nonprofit operator holding rents below market?

Issues to Consider

Will Direct Capitalization work or should Yield Capitalization be used?

Direct Cap (converting 1 year of NOI into value)

when property is stabilized & income & expenses are expected to have regular patterns over time. Risk-for deals with large soft debt may show no value after you subtract soft debt.

Yield Cap (discounted cash flow)

when property has irregular income patterns (tax abatement wears off), property is not stabilized, large fluctuations in income as property converts from LIHTC to Market Rate, cash flow restrictions per reg agreement, ground lease payments, (benefit to stay in deal long term if below market debt, etc).

Discounted Cash Flow Analysis

Appropriate discount rate?

Appropriate reversionary cap rate?

Typical holding period?

Discounted Cash Flow Analysis

How to Determine Discount Rate

- PwC Survey averages
- Current Cap Rates Plus Growth Factor for investment horizon
(250 to 350 basis points higher)

Reversionary Cap Rate

- Current Cap Rates
- Length of the holding period
- Minimum of 50 basis points higher than going-in cap rates
- Factor is added for (longer) holding period as well as smaller pool of potential purchasers

Liquidation Vs. Going Concern

Liquidation Scenario

- Unwinding partnership
- No discount for control, marketability
- Buy out terms

Going Concern Scenario

- Partnership Continues
- It is a Partial Interest
- Will have discount for lack of control and marketability (LOCM) which means a lower value.
- Do buy out terms indicate deductions for LOCM?
- Appropriate discount dictated by risk, size, location, etc.

Other Key Yr. 15 Market Observations

- Residual value varies greatly
- What about no value deals?
- Transactions are all complex and different
- Multiple approvals often necessary
- Tax implications further complicate transactions

Questions?

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