

Valuation Techniques

Today's speakers



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How do you turn this
into a deal?

SUDDEN VALLEY APARTMENTS

Valuation in Open Market Sale

	Value Today Open Market Sale	
Valuation Scenario	High Value	Low Value
Proceeds Available for Distribution	\$ 2,876,025	\$ 2,529,275

Capital Transactions Waterfall Scenarios	Value Today Open Market Sale	
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Priority 1				
Unpaid IM PD				
	Balance		11,501	11,501
	Payment		11,501	11,501
	Remaining Proceeds		2,864,524	2,517,774
Priority 2				
Return of Adjusted Investor Capital				
	Adjusted Investor Capital	108.7%	2,714,679	2,714,679
	Investor Member Payment	99.0%	2,714,679	2,492,596
	Managing Member Payment	1.0%	27,421	25,178
	Remaining Proceeds		122,424	(0)
Priority 3				
Unpaid Incentive Mgmt Fees				
	Balance		39,371	39,371
	Payment		39,371	(0)
	Remaining Proceeds		83,052	0
Priority 4				
Return of Adjusted MM Capital				
	Adjusted MM Capital		25,226	25,226
	Payment		25,226	0
	Remaining Proceeds		57,826	0
Residual Split				
	LP Share	50.0%	28,913	0
	GP Share	50.0%	28,913	0
Total Proceeds to LP			2,755,093	2,504,097
Total Proceeds to GP			120,932	25,178



Getting to Yes



“What’s your exit strategy?”

How do developers and investors bridge the (sometimes big) gap between their expectations to negotiate a successful exit at or around the end of compliance?

Agenda

- 1. Framing:** What is each party thinking about?
- 2. Preparation:** What to do before embarking on a Year 15?
- 3. Process:** How does valuation work?
- 4. Case Studies:** How do these play out in practice?





Section 1: Framing

Developer vs. Investor Motivations

Developers care about:

- / Usually want control of property
 - Maintain existing cash distributions and fees
 - Control future decisions
 - Refinancing
 - Re-syndication (next developer fee)
 - Sale
- / They don't want
 - Investor claiming upside
 - Drain/divvy up reserves
 - Pay a lot, especially out of pocket
- / If the property has capital needs, want those costs shared or expedited

Investors care about:

- / Usually want timely exit after end of compliance
 - LIHTC benefits have been delivered
 - Recapture risk has burned off
 - Tax losses of limited value
 - Wind down funds
- / Maintain relationship for future deals
- / They don't want
 - To leave money on the table on valuable properties
 - Long drawn-out processes (esp. if there's a fund to close out)

Things to Think About

- / The tax credit partner at exit is not necessarily who it was at 8609
- / Some investors highly motivated by residual value
 - Some care relatively less
 - Residual value varies greatly
 - Both parties will likely know if there is residual value, although opinions of value may be (very) different
- / Developers vary widely in their level of sophistication, familiarity, and comfort with Y15
- / The political / relationship / qualitative considerations are very real and relevant
 - GPs and LPs vary greatly in their appetite for conflict and adversarial negotiation
- / There can be small differences in the incentives for a syndicator vs a multi-fund investor versus a direct investor

The Two Types of Waterfalls

OPERATIONAL CASH FLOW



Permanent Loan Payment



Tax Credit Asset Management Fee



Cashflow Developer Fee

75%



25%



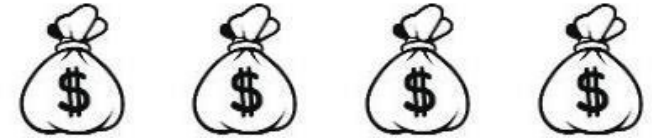
Residual Receipt
Loan Payment

49% to OO

51% to TCP

Green:
Cash to Owner

SALE REFINANCE PROCEEDS



Permanent Loan Principal Repayment



Residual Receipt Loan Repayment



90% to Original Owner

10% to TCP





Section 2: Preparation for year 15

How to Achieve a Successful Exit

Start discussion early

Can take much longer than anticipated

- / Negotiation over value
 - GP/LP obtain indications of value – BOVs and/or formal appraisals
 - Getting someone's attention
 - Internal bureaucracy
 - Approvals

Understand all key provisions of partnership and regulatory agreements

- / Partner rights
- / Purchase option and/or right of first refusal agreement
- / Put/Call option
- / Regulator restrictions

Partnership debt

- / Prepayment penalties/lockouts
- / DDF requirements

Capital accounts and tax consequences

If you need a partner approval for something else, use the opportunity to begin the discussion on exit

Detailed Financial Analysis

	Pro Forma Current Leases		Pro Forma Max LIHTC	
Income				
Scheduled Market Rent	\$705,447	{1}	\$756,732	
Less: (Loss) to Lease	\$-	0.0%	\$(18,918)	-2.5%
Less: Vacancy	\$(14,109)	-2.0%	\$(15,135)	-2.0%
Less: Concessions / Bad Debt	\$-	0.0%	\$-	0.0%
Net Rental Income	\$691,338		\$722,679	
Plus: Other Income	\$7,000		\$7,000	
Total Real Estate Income	\$698,338		\$729,679	
Expenses				
Administrative	\$30,000		\$30,000	
Advertising & Promotion	\$2,500		\$2,500	
Payroll	\$62,500		\$62,500	
Repairs & Maintenance / Turnover	\$90,000		\$90,000	
Management Fee	\$27,934	4.00%	\$29,187	4.00%
Utilities	\$82,000		\$82,000	
Contracted Services	\$38,000		\$38,000	
Real Estate Taxes	\$70,622	{2}	\$57,073	{4}
Insurance	\$30,530	\$710	\$30,530	\$710
Replacement Reserve	\$12,900	\$300 {3}	\$12,900	\$300 {3}
Total Expenses	\$446,985		\$434,690	
<i>Total Expenses / Unit</i>	<i>\$10,395</i>		<i>\$10,109</i>	
Net Operating Income	\$251,352		\$294,989	

Valuation Analysis

		Pro Forma Current Leases
Cap Rate	4.50%	\$5,586,000
<i>Per Unit</i>		<i>\$129,907</i>
		Pro Forma Max LIHTC
Cap Rate	4.50%	\$6,555,000
<i>Per Unit</i>		<i>\$152,442</i>

Opportunity Summary

Estimated Sales Proceeds Calculation - Current Leases

Pro Forma NOI:		\$251,352
Cap Rate:		4.50%
Rounded Valuation:		\$5,586,000
	<i>Per Unit:</i>	<i>\$129,907</i>
Less: Brokerage Fee	4.5%	\$251,370
Plus: Cash and Reserves		\$242,056
Available to Pay Debts		\$5,576,686
Less: Outstanding Mortgages		\$2,557,326
Less: Prepayment Penalty*	2.0%	\$51,147
Less: Current Liabilities		\$123,094
Less: Development Fee		\$0
Funds Available for Distribution:		\$2,845,119

Estimated Sales Proceeds Calculation - Max LIHTC

Pro Forma NOI:		\$294,989
Cap Rate:		4.50%
Rounded Valuation:		\$6,555,000
	<i>Per Unit:</i>	<i>\$152,442</i>
Less: Brokerage Fee	4.5%	\$294,975
Plus: Cash and Reserves		\$0
Available to Pay Debts		\$6,260,025
Less: Outstanding Mortgages		\$2,557,326
Less: Prepayment Penalty*	2.0%	\$51,147
Less: Current Liabilities		\$123,094
Less: Development Fee		\$0
Funds Available for Distribution:		\$3,448,635

Capital Account Analysis

Projected Distribution of Sale Proceeds

Year of Sale	2022		
	Gross Sales Price (Current Leases NOI)		\$5,586,000
Section 11.2(B)(1)	Less: Selling Costs	4.50%	\$251,370
Section 11.2(B)(1)	Less: Estimated Prepayment	2.00%	\$51,147
	Plus: Cash/Reserves		\$242,056
	Net Sales Proceeds		\$5,525,539
Section 11.2(B)(2)	Payments of debt and liabilities of the Company, excluding amounts due to Members / Affiliates		
		Mortgage	\$2,557,326
		Current Liabilities	\$123,094
		Available for Distribution	\$2,845,119
Section 11.2(B)(3)	Setting up any Reserves the Liquidator deems necessary		\$-
Section 11.2(B)(4)	Payment of any outstanding Partner Loans		\$803,867
Section 11.2(B)(5)	Return of LP Capital Contributions		\$1,694,159
Section 11.2(B)(6)	Return of GP Capital Contributions		\$2
Section 11.2(B)(7)	80% of Remainder for Disposition Fee to GPs		\$277,673
	Net Sales Proceeds		\$69,418
Allocable Split Between Members			
Section 11.2(B)(8)	General Partner:	0.005%	\$3
Section 11.2(B)(8)	General Partner:	0.005%	\$3
Section 11.2(B)(8)	Limited Partner:	99.99%	\$69,411
			\$69,418

Capital Account Analysis, Cont.

Projected Gain Calculation

Net Sales Price (Cash Less Selling Costs, Prepayment)				\$5,283,483
Projected Adjusted Basis of Property (including Prepaid Assets, AR, Intangibles)				\$993,738
Gain (Loss) on Sale of Property				\$4,289,745
Disposition Fee				\$277,673
Net Gain (Loss) Allocated to Partners				\$4,012,072

	General Partner	General Partner	Limited Partner	TOTAL
Projected Ending Capital Accounts (12/31/2021)	\$(183,145)	\$(183,145)	\$(1,882,200)	\$(2,248,493)
Return of Capital	\$(1)	\$(1)	\$(1,694,159)	\$(1,694,161)
Gain to Restore Negative Capital Accounts	\$183,146	\$183,149	\$3,576,359	\$3,942,654
Remaining Gain to Target Allocation	\$3	\$3	\$69,411	\$69,418
Capital Account Balances Post Gain Allocation	\$3	\$3	\$69,411	\$69,418

Projected Cash Payments to Members and Affiliates

	General Partner	General Partner	Limited Partner	TOTAL
Disposition Fee	\$138,837	\$138,837	\$-	\$277,673
Return of Invested Amounts	\$1	\$1	\$1,694,159	\$1,694,161
Sale Distribution	\$3	\$3	\$69,411	\$69,418
Total Cash Payments to Members and Affiliates*	\$138,841	\$138,841	\$1,763,570	\$2,041,252

* Value of Interest to Respective Member

Start with Partnership Agreement

Business deal is (hopefully) memorialized in the partnership agreement

/ Specificity of language varies and intent is not always clear

Key Sections:

- / Capital Transactions Waterfall (the business deal)
- / Liquidation provisions (the tax reality)
- / Cash Flow Splits & Capital Event Splits
- / Purchase Option and/or Right of First Refusal
 - For property or partner interest
- / Put or Call Option
- / Investor rights to force sale or Qualified Contract
- / Investor rights to sell its interest to a 3rd party

Estimate of property value

+

application of partnership agreement

=

value estimate of partner interest

This is just the beginning!

Evaluating Options

Developer Options

- / What is the long-term strategy?
- / Possession of preferential purchase rights? Do rights have expirations?
- / Will capital account issue affect ROFR?
- / Refinance
 - Low interest rates
 - Fannie/Freddie, FHA loans
- / Re-syndicate
 - Bonds and 4% credits
- / Qualified Contract

Investor Options

- / What is desired outcome?
- / What is the urgency of exit?
- / Forced sale
- / Sale of Interest
- / Donation
- / Wait it out

Sales to third party buyers are uncommon but do occur

- / Existing affordable and market-rate owners
 - Low-risk return or upside through renovation
- / Preservation funds and CRA-motivated buyers
- / Developers looking to build pipeline/enter new market



Section 3: The Process of Valuation

At or Near Year 15: Type of Valuation

Internal Property Valuation

Problems – GP & LP value may be substantially different

Many partnership agreements require an independent appraisal

May be more helpful early on as part of initial discussions

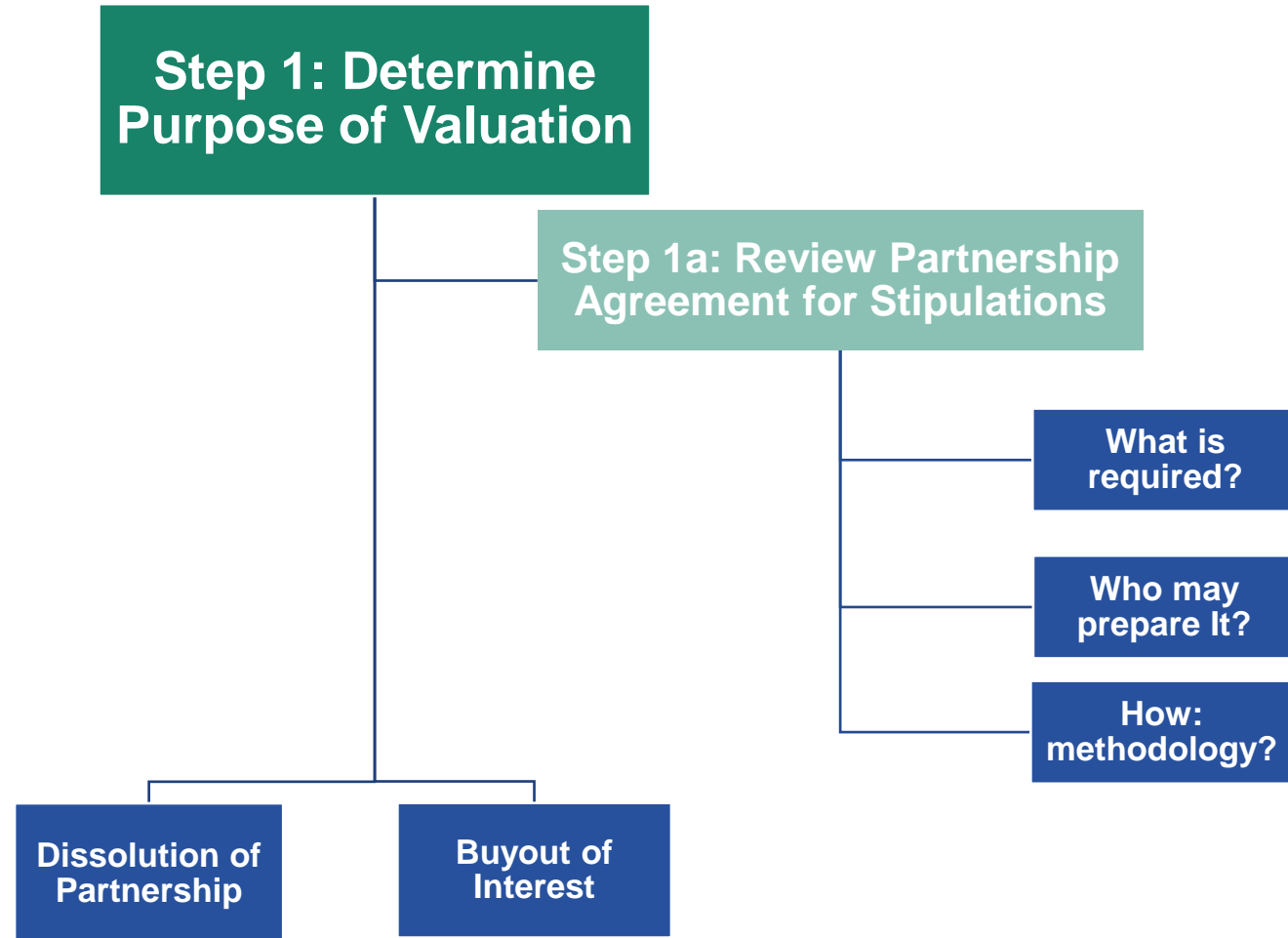
Market Value – Underlying Real Estate Asset first

More supportable for legal proceedings

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

Depending on ultimate exit approach and purpose, may be required

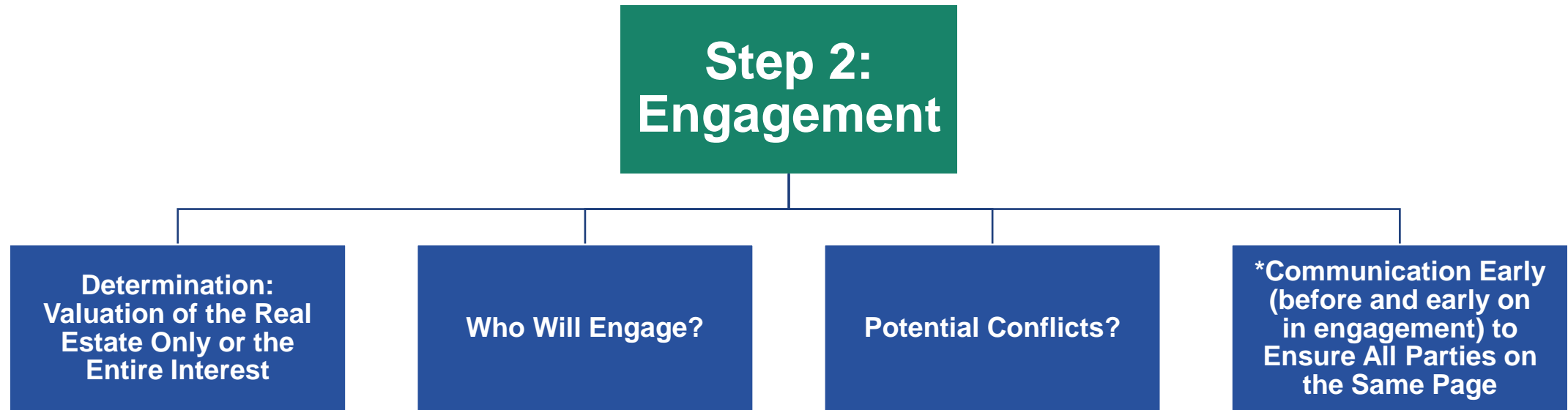
Value of LIHTC Property at (or near) Year 15: Process



Partnership Agreement Stipulations

- / Prior 12 months Income (Gross, Net, PGI, NOI?)
- / MAI/Years of Experience?
- / Who orders the appraisal/process?
- / Determination regarding discounts?
- / Capitalization rate determination?
- / Others?

Value of LIHTC Property at (or near) Year 15: Process



Components to Real Estate Value

Other 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?), QC.**

**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?**

Valuation Approach

Will Direct Capitalization work or should Yield Capitalization be used?

Direct Cap

(converting 1 year of NOI into value)

when property is stabilized and income and 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.

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