VALUATION TECHNIQUES

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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**	
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?

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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)

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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

Green:
Cash to Owner

OPERATIONAL CASH FLOW

- Permanent Loan Payment
- Tax Credit Asset Management Fee
- Cashflow Developer Fee
  - 75%: Residual Receipt Loan Payment
  - 25%: 49% to OO | 51% to TCP

SALE REFINANCE PROCEEDS

- Permanent Loan Principal Repayment
- Residual Receipt Loan Repayment
- 90% to Original Owner | 10% to TCP

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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 & 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

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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**		
Total Expenses / Unit	*$10,395*			*$10,109*		
Net Operating Income	**$251,352**			**$294,989**		

Valuation Analysis

		Pro Forma Current Leases
Cap Rate	**4.50%**	**$5,586,000**
Per Unit		*$129,907*

		Pro Forma Max LIHTC
Cap Rate	**4.50%**	**$6,555,000**
Per Unit		*$152,442*

Opportunity Summary

Estimated Sales Proceeds Calculation - Current Leases

Pro Forma NOI:		$251,352
Cap Rate:		4.50%
Rounded Valuation:		**$5,586,000**
	Per Unit:	*$129,907*
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**
	Per Unit:	*$152,442*
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*

NONPROFIT ROFR

Commencing on the 15th anniversary of the first day of the first taxable year of the Compliance Period and ending one year thereafter, a qualified 501(c)(3) Affiliate of the General Partner shall have a right of first refusal to purchase the Project at a price (the “Purchase Price”) equal to (i) the amount of outstanding indebtedness secured by the Project, (ii) the amount of federal, state and local tax liability projected to be imposed on the Partners as a result of the sale pursuant to the right of first refusal, including federal income tax liability incurred due to the payment of amounts pursuant to this clause (ii), (iii) the amount of any unreimbursed deficiency in Credits recognized by the Investment Partner as compared to the Projected Credits, and (iv) amounts owed to the Special Limited Partner and the Investment Partner pursuant to this Agreement.

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 third 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

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

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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)

PARTNERSHIP AGREEMENT STIPULATIONS

/ Prior 12 months Income (Gross, Net, PGI, NOI?)

/ MAI (pitfalls?)

/ If it's not a Buyout – are stipulations applicable?

/ Others?

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

- Should be market oriented in that the value needs to rely on both historical operations as well as typical operations in the “market”
- Analysis of historical operations alone is insufficient

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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).

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DISCOUNTED CASH FLOW ANALYSIS

Appropriate discount rate?	Appropriate reversionary cap rate?	Typical holding period?

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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

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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.

QUESTIONS?

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