

Unlocking Value and Seizing Opportunities in Year 15

# OWNER/GP & LP PERSPECTIVES

**Learn the Basics: Housing Tax Credits 101**

April 5, 2019 | Boston, MA



## KEY QUESTIONS

- Common perspectives of today's GPs and LPs?
- Financing strategies and sources being used?
- How to Achieve a Successful Year 15 transaction?

SUDDEN VALLEY APARTMENTS  
Valuation in Open Market Sale

| Valuation Scenario                         | Value Today<br>Open Market Sale |                     |
|--|---------------------------------|---------------------|
|  | High Value                      | Low Value           |
| <b>Proceeds Available for Distribution</b> | <b>\$ 2,876,025</b>             | <b>\$ 2,529,275</b> |
| Capital Transactions Waterfall Scenarios   |                                 |                     |
| Value Today<br>Open Market Sale            |                                 |                     |
| <b>Priority 1</b>                          |                                 |                     |
| <b>Unpaid IM PD</b>                        |                                 |                     |
| Balance                                    | 11,501                          | 11,501              |
| Payment                                    | 11,501                          | 11,501              |
| Remaining Proceeds                         | 2,864,524                       | 2,517,774           |
| <b>Priority 2</b>                          |                                 |                     |
| <b>Return of Adjusted Investor Capital</b> |                                 |                     |
| 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)                 |
| <b>Priority 3</b>                          |                                 |                     |
| <b>Unpaid Incentive Mgmt Fees</b>          |                                 |                     |
| Balance                                    | 39,371                          | 39,371              |
| Payment                                    | 39,371                          | (0)                 |
| Remaining Proceeds                         | 83,052                          | 0                   |
| <b>Priority 4</b>                          |                                 |                     |
| <b>Return of Adjusted MM Capital</b>       |                                 |                     |
| Adjusted MM Capital                        | 25,226                          | 25,226              |
| Payment                                    | 25,226                          | 0                   |
| Remaining Proceeds                         | 57,826                          | 0                   |
| <b>Residual Split</b>                      |                                 |                     |
| LP Share 50.0%                             | 28,913                          | 0                   |
| GP Share 50.0%                             | 28,913                          | 0                   |
| <b>Total Proceeds to LP</b>                | <b>2,755,093</b>                | <b>2,504,097</b>    |
| <b>Total Proceeds to GP</b>                | <b>120,932</b>                  | <b>25,178</b>       |

# VALUATION TECHNIQUES



## GETTING TO YES

How do developers and investors bridge the (sometime significant) gap and negotiate a successful exit at or around the end of compliance?



*"What's your exit strategy?"*

# DEVELOPER VS INVESTOR MOTIVATIONS

- Developers usually want control of property
  - Maintain existing cash distributions and fees
  - Control future decisions
    - Refinancing
    - Re-syndication
    - Sale
  - Don't want existing investor claiming upside
- Investors 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
- Who you tax credit partner is today is not necessarily who it was at 8609
- Some investors highly motivated by residual value
- Residual value varies greatly
- Both parties will likely be aware if there is residual value, although opinions of value may be (very) different

## FINANCING STRATEGIES AND SOURCES

- Low interest rate environment
- Access to low-cost, friendly and local capital
- Fannie/Freddie vs. FHA Loans
- Some owners using their own funds to buy-out LPs
- Re-syndication strategies

# HOW TO ACHIEVE A SUCCESSFUL EXIT

- Start discussion early
  - Can take much longer than anticipated
    - Negotiation over value
    - Getting someone's attention
    - Internal bureaucracy
    - Approvals
- Understand all key provisions of partnership agreement 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

# 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?
  - Forced sale
  - Interest sale
  - 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

## ...WILL RESULT IN BETTER OPTIONS & EXECUTIONS

- Gather the information
- Identify critical information
- Create a valuation model to value and compare options
- Create a stakeholders memo (is your strategy sound?)
- Does your strategy add up? (do the math)

## GATHER THE RIGHT INFORMATION

- The last three years of Audited Financial Statements
- The Limited Partnership Agreement and Amendments
- Option Agreements & ROFR
- LURA and any other regulatory agreements
- Current rent roll, operating statements and budget
- The (2) most recent site visit reports or Capital Needs Assessment
- 2 years of Tax Returns including Form 8609
- Loan documents.
- Appraisals or Broker Opinion of Value (if available)

## WHAT TO LOOK FOR...

**AFS:** Notes, related party transactions, audit concerns, YTY changes.

**PA:** Who controls, who has leverage, consents, timing, process.

**Options/ROFR:** Control, timing, participants.

**Operating statements:** Well run, income and expenses in range.

**Site visit reports/CNA:** Locational issues, tenant issues, capital needs.

**Loan Docs:** Maturity, balances, lockouts, prepayment penalties, restrictions.

**Tax Returns:** EOC date, partial credits, Capital accounts.

**ALL DOCS:** WHO HAS LEVERAGE, what consents are needed.

The GP says it's worth \$0; the Broker says it's worth \$1 billion...

Investors/Syndicators (the LPs) determine value by asking:

—**What's the market today and in the future?**

Property and investment markets change each year

—**What's possible to do with the property?**

Market sale? 4% execution? Wait for the elusive 9%?

—**What's the Highest and Best Value for the LP on a**

—**RISK ADJUSTED BASIS?**

— **They use a detailed, disciplined Valuation Model.**

# AND ANALYZE HISTORIC OPERATIONS....

| Unit Mix and Rental Income |    |           |         |         |         |       |          |       |   |
|----------------------------|----|-----------|---------|---------|---------|-------|----------|-------|---|
|                            |    |           | Current | Current | Utility | Max   | Unrestr. | Pro   | Section   |
|                            |    |           |         |         |         | Rent  | Rent     |       |   |
| Efficiency/Studio          | 2  | 300 - 454 | 60%     | 350     | 0       | 1,129 | 700      | 385   | Section 8 Contract? <input type="text" value="No"/> |
| JR1BA/1BA                  | 2  | 500       | 60%     | 633     | 0       | 1,209 | 870      | 696   | Units (unit mix above)                              |
| 1BA/1BA Flat               | 13 | 478       | 60%     | 636     | 0       | 1,209 | 800      | 699   | Contract expiration date                            |
| 1BA/1BA                    | 1  | 585       | 60%     | 400     | 0       | 1,209 | 825      | 440   |   |
| 1BA/1BA Den                | 6  | 725       | 60%     | 795     | 0       | 1,209 | 900      | 874   |   |
| 2BA/1BA Flat               | 9  | 577       | 60%     | 862     | 209     | 1,243 | 850      | 948   |   |
| 2BA/1BA Den                | 20 | 767       | 60%     | 824     | 209     | 1,243 | 970      | 907   |   |
| 2BA/1BA                    | 2  | 800       | 60%     | 975     | 209     | 1,243 | 1,000    | 1,073 |   |
| 3x1 TH                     | 8  | 833       | 60%     | 952     | 250     | 1,427 | 1,070    | 1,047 |   |
| 4TH                        | 1  | 1,000     | 60%     | 890     | 297     | 1,573 | 1,125    | 979   |   |
|                            |    |           |         |         |         |       |          |       |   |
|                            |    |           |         |         |         |       |          |       |   |
|                            | 64 | 655       |         | 783     | 137     | 1,256 | 914      | 861   |   |

\* Current rents includes excess S8 rents.

## Historic Operations

| <b>Per Audits</b> |           |           |           |           |           |           |
|-------------------|-----------|-----------|-----------|-----------|-----------|-----------|
| Rent (EGI)        | 467,786   | 490,460   | 436,010   | 426,670   | 489,395   | 496,396   |
| Expenses          | (419,367) | (468,164) | (412,278) | (399,377) | (445,824) | (371,190) |
| RR Deps           | (11,086)  | (12,792)  | (8,528)   | (8,528)   | (12,792)  | (12,792)  |
| NOI               | 37,333    | 9,504     | 15,204    | 18,765    | 30,779    | 112,414   |
| Debt Service      | (40,490)  | (3,864)   | (42,980)  | (50,367)  | (51,581)  | (53,657)  |
| Cash Flow         | (3,157)   | 5,640     | (27,776)  | (31,602)  | (20,802)  | 58,757    |

**5 Yr Rent Growth -1.19%**  
**5 Yr Expense Growth +26%**  
**5 Yr NOI Growth -91%**

# PROFORMA REVIEW

|                                    | Historical Audit |                |              | Quarterly Financials |                |              | Pro Forma - Restricted |                |              |
|------------------------------------|------------------|----------------|--------------|----------------------|----------------|--------------|------------------------|----------------|--------------|
| <b>Operating Income</b>            |                  |                |              |                      |                |              |                        |                |              |
| Gross Rental Income                |                  | 561,733        |              |                      | 558,363        |              |                        | 565,412        |              |
| Vacancy                            | 14%              | (79,895)       |              | 16%                  | (87,760)       |              | 15%                    | (83,493)       |              |
| Bad Debt and Concessions           | 1%               | (7,468)        |              | 0%                   | -              |              | 0%                     | -              |              |
| Other Income                       |                  | 16,090         | 251          |                      | 10,999         | 172          |                        | 6,225          | 97           |
| <b>Total Income</b>                |                  | <b>490,460</b> |              |                      | <b>481,602</b> |              |                        | <b>488,144</b> |              |
| <b>Operating Expenses</b>          |                  |                |              |                      |                |              |                        |                |              |
| Management Fee                     | 0%               | -              | -            | 0%                   | -              | -            | 0%                     | -              | -            |
| Admin/Misc.                        |                  | 111,649        | 1,745        |                      | 107,646        | 1,682        |                        | 114,969        | 1,796        |
| Utilities                          |                  | 42,959         | 671          |                      | 43,675         | 682          |                        | 43,659         | 682          |
| Maint                              |                  | 150,659        | 2,354        |                      | 205,216        | 3,207        |                        | 170,267        | 2,660        |
| Payroll                            |                  | 118,585        | 1,853        |                      | 52,414         | 819          |                        | 76,668         | 1,198        |
| RE Taxes                           |                  | -              | -            |                      | -              | -            |                        | -              | -            |
| Insurance                          |                  | 26,925         | 421          |                      | 21,020         | 328          |                        | 31,909         | 499          |
| Marketing                          |                  | -              | -            |                      | -              | -            |                        | -              | -            |
| Land Lease                         |                  | 17,388         | 272          |                      | 17,388         | 272          |                        | 17,388         | 272          |
| <b>Total Operating Expenses</b>    |                  | <b>468,164</b> | <b>7,315</b> |                      | <b>447,359</b> | <b>6,990</b> |                        | <b>454,860</b> | <b>7,107</b> |
| Less: Replacement Reserve Deposits |                  | 12,792         | 200          |                      | 12,792         | 200          |                        | 12,792         | 200          |
| <b>Net Operating Income</b>        |                  | <b>9,504</b>   |              |                      | <b>21,451</b>  |              |                        | <b>20,492</b>  |              |
| Hard Debt Service                  |                  | (3,864)        |              |                      |                |              |                        |                |              |
| DSCR                               |                  | 2.46           |              |                      |                |              |                        |                |              |
| Net Cash Flow                      |                  | 5,640          |              |                      |                |              |                        |                |              |

**No management fee - GP provides management services without compensation. Estimated Proforma income and expenses to match consultant's 2014 proforma**

# VALUATION SUMMARY

## Property Valuation Summary

| SCENARIO                    | Property Value | Price Per Unit | LP Proceeds (Waterfall) | LP Proceeds (Capital Acct) | GP Proceeds (Waterfall) | GP Proceeds (Capital Acct) |
|-----------------------------|----------------|----------------|-------------------------|----------------------------|-------------------------|----------------------------|
| Market Value (restricted)   | 2,009,935      | 31,405         | 1,471,903               | 1,074,414                  | -                       | 397,443                    |
| 4% Resyndication            | 1,240,138      | 19,377         | 717,502                 | 600,454                    | -                       | 117,048                    |
| 9% Resyndication            | 2,112,948      | 33,015         | 1,572,856               | 1,124,880                  | -                       | 447,919                    |
| ROFR Price                  | 483,455        | 7,554          | -                       | -                          | -                       | -                          |
| Option Price                | 3,147,845      | 49,185         | 2,587,055               | 1,631,879                  | -                       | 955,019                    |
| Qualified Contract Price    | 4,766,116      | 74,471         |                         |                            |                         |                            |
| Market Value ( no restrict) | 3,147,845      | 49,185         | 2,587,055               | 1,631,879                  | -                       | 955,019                    |
| LP Cash Flow Multiple       |                |                | 33,310                  | 33,310                     |                         |                            |
| Refinance Scenario          |                |                | 1,130,953               |                            | -                       |                            |

### CONCLUDED SALE VALUE

Accrued SLP Fees & Proceeds

### TOTAL TO LPs

|                  |               |                  |                  |   |                |
|------------------|---------------|------------------|------------------|---|----------------|
| <b>2,000,000</b> | <b>31,250</b> | <b>1,462,167</b> | <b>1,069,547</b> | - | <b>392,574</b> |
|                  |               | 28,000           | 28,046           |   |                |
|                  |               | <b>1,490,167</b> | <b>1,097,593</b> |   |                |

2015 NOI  
Avg 5 Yr. NOI

|        |             |
|--------|-------------|
| 9,504  | <b>0.5%</b> |
| 37,333 | <b>1.9%</b> |



| Property Purchase Price | Partnership Net   |               |                      | Gross Sales Proceeds | Repayment of debt and obligations due upon sale, other than amounts to Partners | SLP Fees | Unpaid balance of Voluntary Loan | Capital Account Splits |     |         | Residual Splits |     |           | Totals    |        |           |    |     |    |
|-------------------------|-------------------|---------------|----------------------|----------------------|---|----------|----------------------------------|------------------------|-----|---------|-----------------|-----|-----------|-----------|--------|-----------|----|-----|----|
|                         | Cash and Reserves | 3rd Party A/P | Transaction expenses |                      |   |          |                                  | LP                     | SLP | GP      | LP              | SLP | GP        | LP        | SLP    | GP        | LP | SLP | GP |
|                         |                   |               |                      |                      |   |          |                                  |                        |     |         |                 |     |           |           |        |           |    |     |    |
| 2,000,000               | 66,619            | (22,997)      | (70,000)             | 1,973,622            | 483,455   | 30,000   | 49,201                           | 840,946                | 0   | 163,928 | 203,005         | 41  | 203,046   | 1,043,952 | 30,041 | 416,175   |    |     |    |
| 2,250,000               | 66,619            | (22,997)      | (75,000)             | 2,218,622            | 483,455   | 30,000   | 49,201                           | 840,946                | 0   | 163,928 | 325,481         | 65  | 325,546   | 1,166,427 | 30,065 | 538,675   |    |     |    |
| 2,500,000               | 66,619            | (22,997)      | (80,000)             | 2,463,622            | 483,455   | 30,000   | 49,201                           | 840,946                | 0   | 163,928 | 447,956         | 90  | 448,046   | 1,288,903 | 30,090 | 661,175   |    |     |    |
| 2,750,000               | 66,619            | (22,997)      | (85,000)             | 2,708,622            | 483,455   | 30,000   | 49,201                           | 840,946                | 0   | 163,928 | 570,432         | 114 | 570,546   | 1,411,378 | 30,114 | 783,675   |    |     |    |
| 3,000,000               | 66,619            | (22,997)      | (90,000)             | 2,953,622            | 483,455   | 30,000   | 49,201                           | 840,946                | 0   | 163,928 | 692,907         | 139 | 693,046   | 1,533,854 | 30,139 | 906,175   |    |     |    |
| 3,250,000               | 66,619            | (22,997)      | (95,000)             | 3,198,622            | 483,455   | 30,000   | 49,201                           | 840,946                | 0   | 163,928 | 815,383         | 163 | 815,546   | 1,656,329 | 30,163 | 1,028,675 |    |     |    |
| 3,500,000               | 66,619            | (22,997)      | (100,000)            | 3,443,622            | 483,455   | 30,000   | 49,201                           | 840,946                | 0   | 163,928 | 937,858         | 188 | 938,046   | 1,778,805 | 30,188 | 1,151,175 |    |     |    |
| 3,750,000               | 66,619            | (22,997)      | (105,000)            | 3,688,622            | 483,455   | 30,000   | 49,201                           | 840,946                | 0   | 163,928 | 1,060,334       | 212 | 1,060,546 | 1,901,280 | 30,212 | 1,273,675 |    |     |    |
| 4,000,000               | 66,619            | (22,997)      | (110,000)            | 3,933,622            | 483,455   | 30,000   | 49,201                           | 840,946                | 0   | 163,928 | 1,182,809       | 237 | 1,183,046 | 2,023,756 | 30,237 | 1,396,175 |    |     |    |
| 4,250,000               | 66,619            | (22,997)      | (115,000)            | 4,178,622            | 483,455   | 30,000   | 49,201                           | 840,946                | 0   | 163,928 | 1,305,285       | 261 | 1,305,546 | 2,146,231 | 30,261 | 1,518,675 |    |     |    |
| 4,500,000               | 66,619            | (22,997)      | (120,000)            | 4,423,622            | 483,455   | 30,000   | 49,201                           | 840,946                | 0   | 163,928 | 1,427,760       | 286 | 1,428,046 | 2,268,707 | 30,286 | 1,641,175 |    |     |    |
| 4,750,000               | 66,619            | (22,997)      | (125,000)            | 4,668,622            | 483,455   | 30,000   | 49,201                           | 840,946                | 0   | 163,928 | 1,550,236       | 310 | 1,550,546 | 2,391,182 | 30,310 | 1,763,675 |    |     |    |
| 5,000,000               | 66,619            | (22,997)      | (130,000)            | 4,913,622            | 483,455   | 30,000   | 49,201                           | 840,946                | 0   | 163,928 | 1,672,711       | 335 | 1,673,046 | 2,513,658 | 30,335 | 1,886,175 |    |     |    |



Test it ...

Draft a compelling memo to your stakeholders.

—Does the deal make sense for everyone?

Draft a Sources and Uses.

- Does everyone (LP, GP, Lenders, all debtors) get paid?
- Is there enough capital (sale or recycle or refi ) to execute?

## CASE STUDY 1

- Garden-style property located in Utah
  - End of compliance in 2016
  - Operates well, produces cash flow after debt
  - Low-leverage bank loan first mortgage, no lockout and no soft debt
- 
- Developer wants to hold, investor wants to exit
  - Investor has right to force a sale, but neither party possesses other purchase rights
  - **Investor's estimate of its interest value is \$1M - \$3M**
  - **Developer initially offers \$500K**

## CASE STUDY 2

- Same facts as Case Study 1
- Except the developer has a purchase option for:
  - The property at the greater of i) fair market value or ii) debt plus investor exit taxes, OR
  - The investor's interest at the greater of i) fair market value or ii) debt plus investor exit taxes
- The investor has a positive capital account
- What if the investor doesn't have a right to force a sale?

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# QUESTIONS?

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