Opportunities in Year 15

IPED’s Learn the Basics: Housing Tax Credits 101
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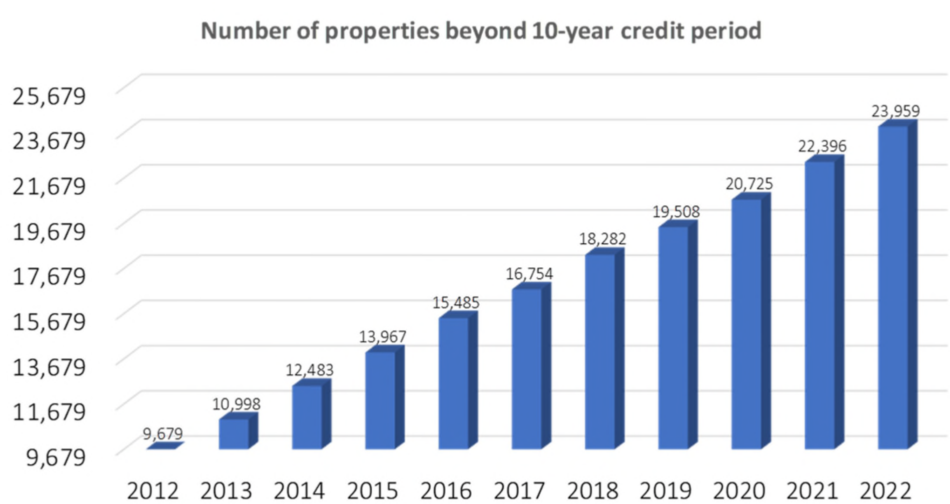

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Key Questions

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

2023

- high interest rates = few refi opportunities, little equity for partners.
- LIHTC pricing has not kept up w increased costs 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.

3rd Party Property Buyers…Market Changing

2022.

- / Existing affordable and market rate owners
- / Developers looking to build a pipeline of LIHTC syndications
- / Private equity partnerships or individuals
- / CRA-motivated buyers.
- / San Antonio year 15 LIHTC deals sold for sub 4 cap.

2023

- / Cap rates are up, property prices down, lender standards tightening.
- / Transaction volume significantly slower.
- / Buyers much more conservative in underwriting.
- / Mind the "Gap" . Many deals don't pencil w/out gap financing.

3rd Party Buyer Perspectives

Third-party buyer incentives:

- / Cash on cash yield 2023 yield expectations higher
- / Plan to improve revenue through renovation and repositioning 2023 more conservative underwriting. Expense growth not 3%, Labor, Insurance ??
- / Rarely anticipating QCP or market rate conversion
- / Expiration of Extended Use on the horizon

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

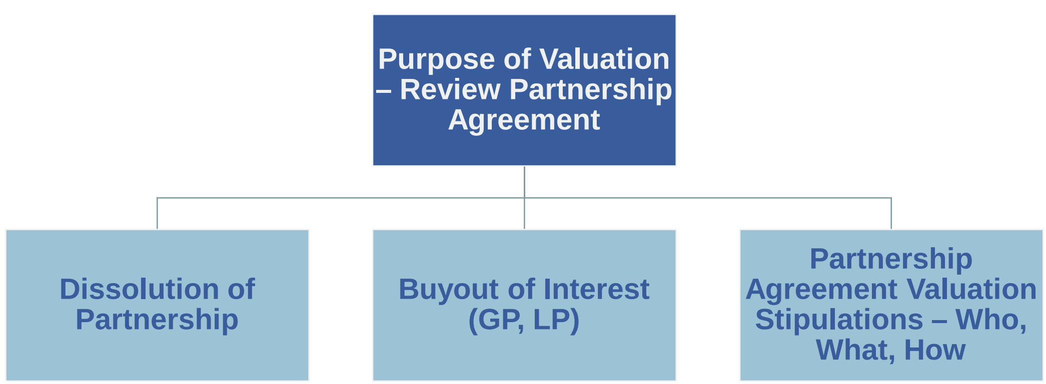
- Capital Accounts – Impact on Splits vs. Partnership Agreement Waterfall. When is the Waterfall not a Waterfall ? Upon dissolution..

/ 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



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)

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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

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Questions?

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Thank you!

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