

LOW-INCOME HOUSING TAX CREDIT CLOSINGS FOR PHAs AND RAD TRANSACTIONS

December 2015

Structure – Tax Credit Syndication

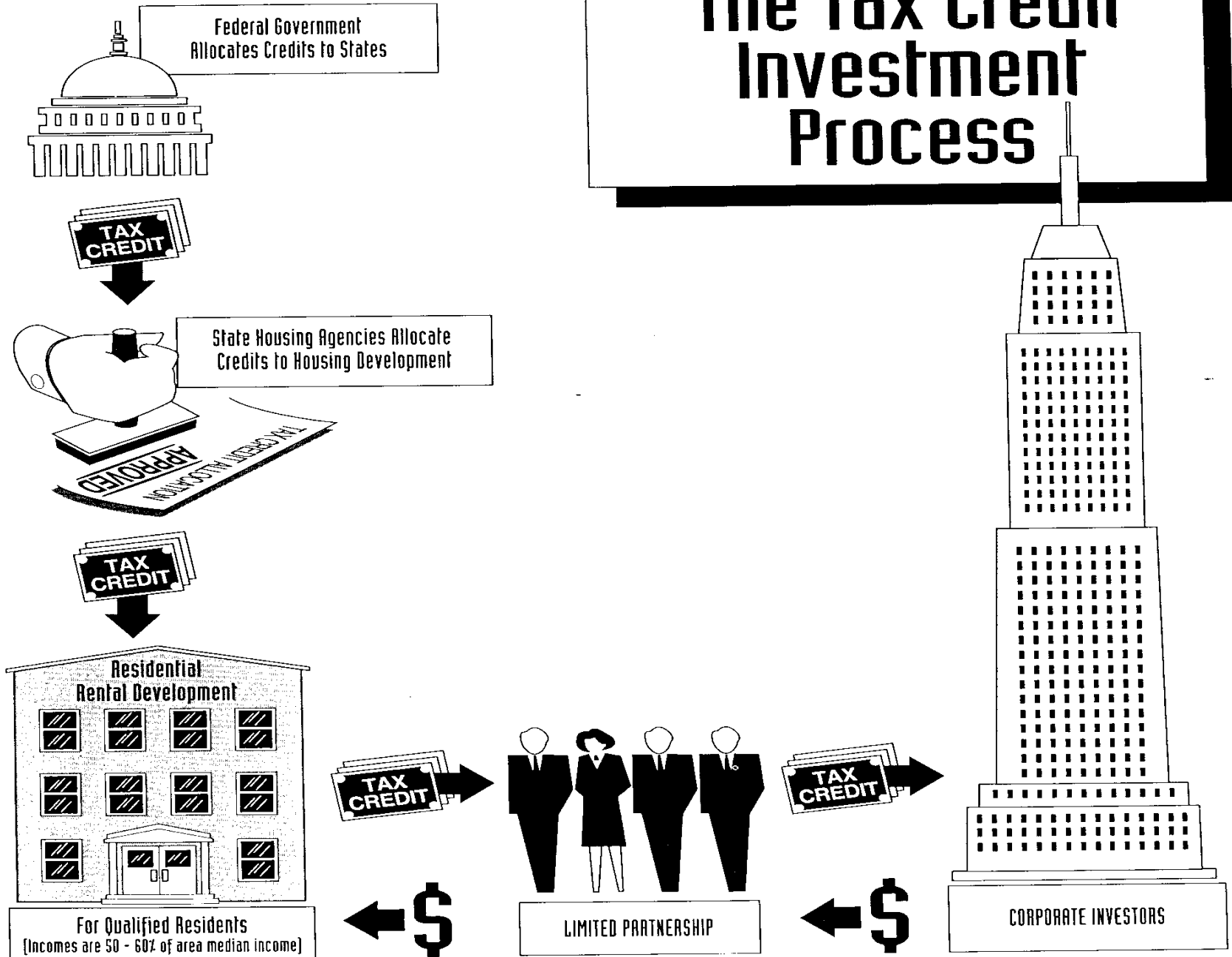
Limited partnership structure

- General partner owns just 0.01%,
but controls and operates the project
- Passive limited partner invests equity
in return for 99.99% ownership

Structure – Tax Credit Syndication

- Sale to Investor Limited Partner of most of the tax credits and tax losses maximizes investor equity
- More investor equity reduces other financing needs and helps project development
- L.P. is a passive investor, and gets its return almost exclusively from the tax credits and losses

The Tax Credit Investment Process



Investor

\$

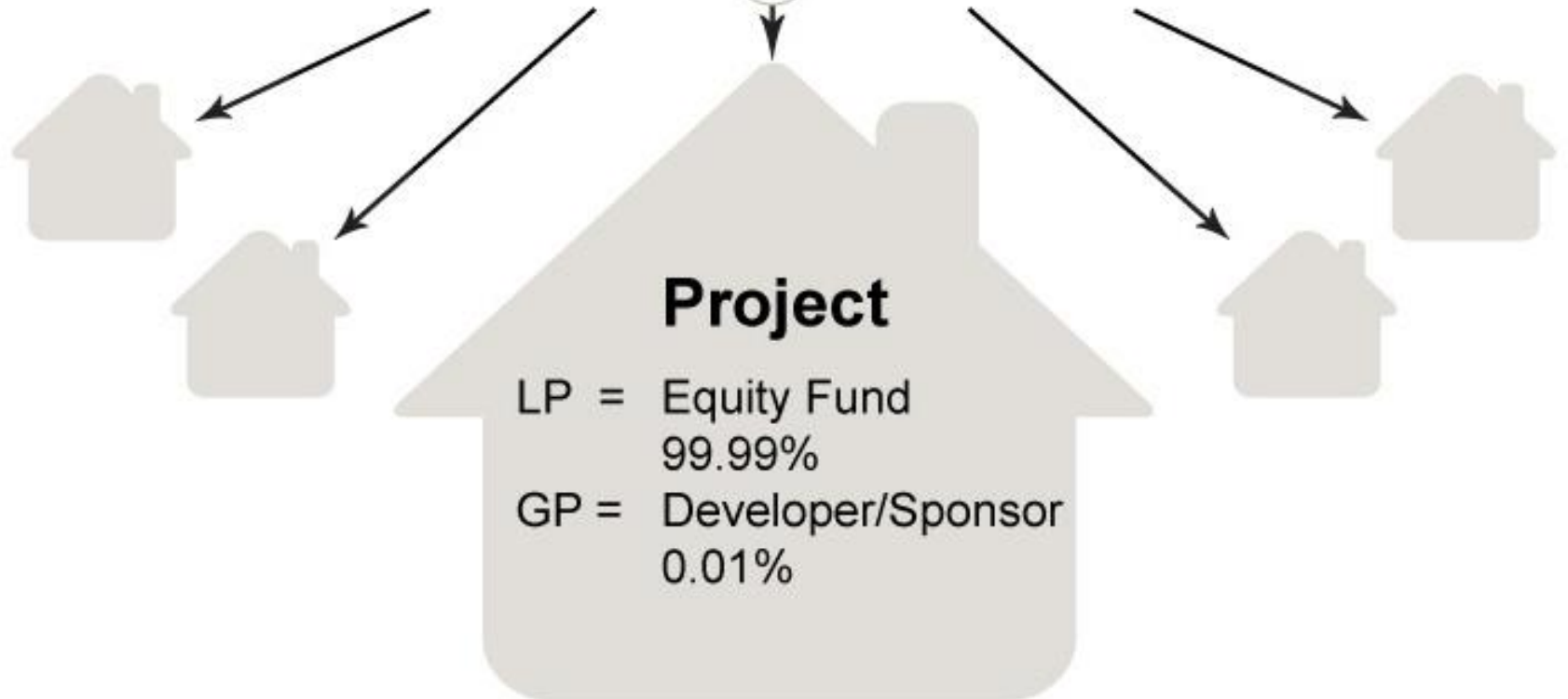
Equity Fund

LP = Investor(s) 99.99%
GP = Enterprise 0.01%

\$

Project

LP = Equity Fund
99.99%
GP = Developer/Sponsor
0.01%



The Parties in a Tax Credit Syndication

- **Development Team**

- Developer
- General contractor
- Architect
- Attorney
- Accountant
- Property manager
- Consultants

- **Lenders**

- Construction lender
- Permanent lenders
- Lender attorneys

- **State Housing Finance Agency**

- **Syndicator**

- Underwriter
- Fund manager
- Attorney

Structuring the Project

- Step 1: Estimate tax credit basis
- Step 2: Estimate tax credits generated
- Step 3: Estimate investor equity
- Step 4: Estimate first mortgage amount
- Step 5: Estimate the funding gap
- Step 6: Fill the gap with a combination of other funds

Sources of Funding to Fill the Gap

- HOME, CDBG funds
- AHP Funds
- ARRA Funds – TCAP and Exchange
- Other Local Funds
- Deferred Development Fee
- Cost Savings (development or acquisition)
- Modification of First Mortgage Terms
- Income or Expense Modifications

Tax Credit Timeline

- Apply for tax credits
- Get a tax credit reservation
- Receive carryover allocation
- Incur more than 10% by required date
- Complete project and place it in service
- Apply for 8609s for all buildings
- Record extended use agreement
- Rent tax credit units to qualified tenants
- Elect when to start tax credits
- Keep tax credit units in compliance

Placing a Project in Service

- New Construction
 - When first unit is ready
 - Certificate of Occupancy
- Rehabilitation – more flexibility
 - No earlier than the date when the rehab equals the greater of:
 - \$6,000 per unit or
 - 20% of acquisition price
 - Lower amount of rehab required if placed in service prior to 07/31/08

Financial Structuring: Kinds of Debt and Grants

“Hard” Debt:

- Must pay, conventional bank debt

- Generally amortizing

“Soft” Debt:

- Generally from governmental agencies

- Cash flow contingent or accruing

- Repayable

Grants: not repayable

Grants

- Grants – funds that are not repayable or cannot be repayable under reasonable assumptions
 - Outright grants
 - Forgivable loans
 - Cannot be repaid at maturity
- Tax treatment
 - Income recognition
 - Potential basis reduction if federal funds

Special Situations

- Historic Tax Credits
 - Add value to a deal, but rigid procedures and approvals are involved.
 - Eligible basis for LIHTC reduced by the amount of the historic credit
- Energy Credits and Green Subsidies
 - Credits for energy efficient appliances, solar energy property and other environmentally beneficial enhancements to project
- Special needs deals have structuring issues related to the length and strength of subsidies

The Syndicator's Approach To Underwriting

- Quality of the Development Team – Including PHA
- Project Characteristics
- Evaluation of the Development Budget
- Rents/ Market/ Marketability
- Operating Costs
- Reserves
- Sponsor Guarantees

Concerns Being Evaluated

- Reputations of the developer, general contractor and other members of the team
- Design considerations of the project
- Quality of materials to be used
- Timelines for construction and lease-up
- Useful life analysis – will it continue to attract tenants as it ages?
- Market analysis – are rents supported by outside analysis?

Quality of the Development Team

- Sponsor/ general partner experience
- Architect/ engineer – design, supervision
- General contractor – size and type of construction, capacity to produce on time
- Attorney and Accountant – experience with tax credit partnership structure and issues – and Mixed Finance/RAD
- Property manager – experience with low-income tenants and management capability
- Consultants to fill in holes in experience

Evaluation of Project Characteristics

- **Need** - does it answer a real need in the community?
- **Finances** - does it meet the syndicator's financial threshold?
- **Quality** - will it continue to attract tenants?
- **Strategic Interest** - does it meet the syndicator's programmatic needs?
- **Geography** - is it located where syndicator and its investors want to invest?

Evaluation of Development Budget

- **Can the project be completed in the time and within budget**
 - What will it cost to build the project?
 - How much is needed to place it in service?
 - What are reasonable timelines?
- **What are the key risk areas to lenders and equity investors and how can the risks be ameliorated?**

Rents/Market/Marketability

- Are rents realistic for the market area?
- What is demand for proposed housing?
 - neighborhood
 - what demographics will project address
- Are tax credit rents sufficiently below area market rents – less of a concern if there is operating subsidy?
- What if subsidy is eliminated?
- Are other funding requirements factored in?

Site Assessment Criteria

- Access to employment and transportation
 - Proximity to downtown or employers
 - Transit
 - Ability to support parking
- Proximity to services and amenities
 - Retail, parks, etc.
- School district quality and proximity to neighborhood schools
- Curb appeal of immediately surrounding uses

Evaluation of Operating Costs

- Examine assumptions for proposed costs
- Are insurance, etc. costs confirmed by bid?
- Are repair and maintenance costs consistent with housing type and family size?
- If there's an elevator, are its costs included?
- Are legal, accounting and administrative costs high enough?
- Are reserves funded in a plausible way?
- Do costs need to be restructured for cash flow?

Structuring Project Reserves

- Reserves are a way to structure for the project's risks
- Operating and lease-up reserves protect against inadequate cash flow
- Replacement reserves provide funds for capital replacement when needed
- Other reserves (for tenant services, etc.) are structured for specific needs or risks

Sources of Funds for Reserves

- Operating reserves usually come from investor equity, but may come from cash flow
- Operating reserves are paid in over time to optimize the use of equity
- Replacement reserves usually are funded from cash flow, but may come from equity
- Some projects need replacements reserves earlier than cash flow permits, requiring equity
- Special-needs housing may not have cash flow for reserves, which may be funded from equity

Sponsor Guarantees

- Allocate costs related to specific risks to the developer and related parties
- Areas where guarantees apply may include:
 - development cost overruns
 - delays in construction completion and lease-up
 - operating deficits until stable operations
 - reduced or delayed tax benefits
 - partnership management

Due Diligence/Closing Items

- Development Team, Guarantor and Contractor Financials
- Identification of Development Team Responsibilities and Development Agreement Draft
- Operating Agreement Draft
- Tax Credit Approval
- ALTA Survey
- Environmental
 - Phase 1 and 2(if necessary)
 - Lead, Asbestos and other building testing
- Geotech and Wetlands
- Title
- Property Management Plan
- P&P Bonds

Long Lead Time Items

- Identification of Guarantors
 - Construction
 - Operating Deficit
- Bidding
- Plan and Cost Review
- Phase 2 and DEQ Approval if Contamination is Present
- Zoning
- Subdivision
- Title
- Tax Credit Approval
- Bond Commission Approval if 4%
- HUD Evidentiary Submission and Approval