Year 15: What’s next? What’s it worth?

October 17, 2013

★ Celia D. Smoot
Senior Program Officer, LISC

★ John Maneval
Director of Lending, NeighborWorks Capital

★ Brian Dowling
Vice President-Community Investments, CDT
1. Expanding investment in housing and other real estate
2. Increasing family income and wealth
3. Stimulating economic activity, locally and regionally
4. Improving access to quality education
5. Fostering livable, safe and healthy environments

MANY CDFIs
ONE PURPOSE

San Francisco Bay Area
Los Angeles
Phoenix
San Diego
Greater Kansas City
Houston
Mid South Delta
Twin Cities
Milwaukee
Duluth
Peoria
Chicago
Detroit
Cincinnati
Buffalo
Toledo
Hartford & Boston
Rhode Island
Philadelphia
Newark & Jersey City
Greater Kansas City
Mid South Delta
Washington, D.C.
Jacksonville
Washington, D.C.
Boston
Rhode Island
Harford & CT Statewide
New York City
Newark & Jersey City
Philadelphia
Rural Pennsylvania
Washington, D.C.

Rural LISC partners serve 1,051 counties in 39 states

30 urban programs

2013 OPPORTUNITY FINANCE NETWORK CONFERENCE
LIISC Investments since 1980

- **$12.9 billion** which has leveraged **$38.3 billion** in total developments
- **298,300** affordable homes & apartments
- **49.2 million** sq ft of retail & community space
- **180** schools financed for 72,000 students
- **184** child care facilities supported for 19,700 children
- **269** playing fields renovated for 467,500 kids

LOW INCOME HOUSING TAX CREDIT ("LIHTC")

- Enacted in 1986

- Over the last 20 years LIHTC program has produced more than 2 million units of affordable rental housing

- Worse Case: More than 1 million LIHTC units could leave the stock of affordable housing by 2020
YEAR 15: What does that mean?

- 15 years after the property is placed in service the tax credit compliance period burns off
- For LIHTC properties with allocations post 1990 there is likely an additional 15 year extended restricted use agreement

REACHING YEAR 15

- Since 2009- Over 10,000 LIHTC projects have reached Year 15
- More than 20,000 LIHTC properties were placed in service from 1995-2009 and will reach Year 15 between 2010 and 2024
# REACHING YEAR 15

Sampling of the Number of Projects over the next 5 years

<table>
<thead>
<tr>
<th>WEST</th>
<th>MIDWEST</th>
<th>EAST</th>
</tr>
</thead>
<tbody>
<tr>
<td>San Francisco</td>
<td>58</td>
<td>Chicago</td>
</tr>
<tr>
<td>Los Angeles</td>
<td>137</td>
<td>Indianapolis</td>
</tr>
<tr>
<td>Phoenix</td>
<td>24</td>
<td>Detroit</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Philadelphia</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Jacksonville</td>
</tr>
</tbody>
</table>

## Year 15: What is the investor thinking?

- Most investors see LIHTC projects as just 15 year investments and will be looking to dispose of their interest in Year 16 (if not earlier).
- As the investor is preparing to exit they will be undertaking a analysis of the **Residual Value** and **Exit Taxes**
RESIDUAL VALUE

★ What is the value of the property in excess of Debt?

★ Cap Rate Analysis (typically taking a three year average of NOI)

★ Typical LPA will have cash waterfall provisions that upon sale or refinance there is a 50/50 split between GP and LP

EXIT TAXES

★ For an investor, exit taxes really means capital gains tax.

★ Review most recent tax return to see what losses are allocated to the investors (typically it will be 99.99% of losses)

★ Losses × increment of 1.35 = Exit Taxes

★ Project operated worse than as projected then likely to be more losses
Intro to NeighborWorks Capital

**Size**
- Total Assets - $50 million --- Loans Outstanding - $40 million

**Impact**
- $100+ million closed across U.S.
- $1.5+ billion in total development cost
- 210+ loans closed
- 10,000 units built or renovated
- 93% of units serve AMI of ≤ 80%

**Market**
- Founded in 2000 with seed capital from NeighborWorks America
- Lend to NeighborWorks America affiliates across U.S.

---

Year 15: CDFI Lending Opportunities

- “Swamp”
- Financially Feasible Transactions
- Parties Agree to Sell/Borrow
- No Economics
- CDFI Business Opportunity
Issues to Consider

- Partnership/LLC Agreement – know the terms
- Collateral Limitations – assignments, guarantys, etc.
- Existing Subordinate Debt – hidden land mines?
- Solid Due Diligence Documentation – annual audits, compliance reports, multiple monitoring agencies
- Compliance Guaranty – Seller assurance of no prior malfeasance
- HFA Involvement/Input – early involvement and strong relationship can enhance value

Year 15: Types of Transactions

- “In the Family” Transactions
  - Right of First Refusal
  - LP Buyout – “early exit” in Years 11-15
  - Resyndication/Refinancing (Bonds/4% or Conventional)
  - Homeownership - Lease Purchase to Residents
  - “Puts” – GP obligation to purchase per Partnership Agreement

- Third-Party Transactions
  - Buying ROFR rights
  - GP Purchase
  - Section 42 Qualified Contract – very rare
  - Resyndication/Recapitalization (Bonds/4% or 9%)
The Community Development Trust

- Nation’s largest REIT specializing exclusively in creating and preserving affordable housing
- Hybrid REIT – We provide permanent debt and long-term equity investments for LIHTC and HUD properties
- $950 million in debt and equity capital to properties in 42 states and regions — helping to preserve or add nearly 33,000 units to the nation’s affordable housing stock.
  - Currently own 5,250 units
  - Currently have 17,400 units in debt portfolio

Market Trends & Challenges

- Rental housing market is hot ... Many market-rate companies or high net worth individuals have entered the affordable market seeking higher economic yields
- Many investment funds or individuals have short-term investment horizons, which run counter to preserving affordability long-term
- Competitive environment pushes people towards more “exotic” (usually shorter-term) debt products
- What happens when restrictions burn off?
Valuing Y-15 Properties

★ Capital Needs
  – Deferred Maintenance -> Resyndication Candidate
  – Well maintained -> More attractive to yield buyers

★ Location, Location, Location
  – Strength of local submarket
  • Discount to market rents, vacancy rates
  – Convenience to transportation, employers, retail, schools, and services
  – Investor Demand (CRA needs)

★ State Housing Agencies (for Resyndication buyers)
  – Qualified Allocation Plan (QAP) for new LIHTC
  – Preservation Focus
  – Qualified Contract Process

Key Underwriting Factors

★ Know the documents
  – Existing mortgage documents (if assuming the debt)
  – Regulatory Agreements

★ Are rents at max. allowable levels with discount to market or does the property compete with Class B/C market-rate properties?

★ Trends in Area Median Income (AMI)

★ Expense Trends
  – How do controllable expenses (payroll, administrative, maintenance) compare to market avg.?
  – Tax abatements?

★ CAPITAL NEEDS
CASE STUDIES

INTERIM FINANCING
GP PURCHASE
LP PURCHASE

INTERIM ACQUISITION FINANCING

★ There is an increasing demand for refinance and acquisition lending for Year 15 projects.

★ Finance the acquisition or refinance balloon or higher interest rate loan for a three to four year term.

★ During that time, the Property is positioned for either refinancing with a long term fixed interest rate permanent financing (LISC/FHA/DUS) or resyndication.
Maple Crest – Port Washington, WI
Post Year 15 Acquisition

- Senior property with 112 units all restricted at 60% AMI
- Built in 1994 through a 9% tax credit allocation and a for-profit sponsor
- Purchased in 2011 by a NP Sponsor
- Acquisition and immediate repairs cost at $5 million financed by LISC and local bank for 3 year term.
- Sponsor plans to stabilize the property and refinanced with FHA

Hill Housing – GP Purchase

**Sponsor: NeighborWorks New Horizons**, New Haven, CT

- 17 buildings, 65-units, 1 to 4 BR
- 30% to 60% AMI
- Stabilize property; make critical repairs; secure permanent financing from the State of Connecticut.
- $750,000 loan to purchase GP and Note
- Issues: LP consent; local approvals; existing lender negotiations
Steinbeck Commons - Salinas, CA
Acquisition at Year 13

- 100-unit, senior LIHTC property
- Originally built in 1983 but rehabbed in 1999 w/ LIHTC
- 100% of the units are covered by a long-term HAP contract
- CDT's $2.1 million equity investment allowed the existing GP to keep the property and buy out the tax credit investor
- Increased reserve funding to meet future capital needs

Celia D. Smoot - Senior Program Officer
 csmoot@lisc.org

John Maneval - Director of Lending
 jmaneval@neighborworkscapital.org

Brian Dowling - VP-Community Investments
 bdowling@cdt.biz