Year 15 Perspectives

Cambridge Housing Authority
Cambridge, MA

May 9, 2023

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Year 15 Planning Begins on Day One

- Establish the economics of your deal and structure it so that the **capital account** and **residual value** projections at Year 15 are favorable to the Housing Authority. If needed change some of the economics to better the outcome for the Housing Authority (e.g. higher or lower loan interest rates or payments on sponsor or soft loans or ground lease terms, limited or no distributions to investor, etc.).
    - Capital account is the value of the investor's equity investment made in the partnership. Deductions are made when the investor receives taxable losses, federal low-income credits or cash distributions during the 15-Year Initial Compliance Period. Ideally you work to keep the capital account positive through Year 15 or an early exit. If it goes negative, a Housing Authority could be responsible for paying exit taxes.
    - Residual value is a projection of the hypothetical sale value of the project at some point in the future, usually the due date of the debt. Investors typically want to know if it reasonable to assume that the debt can be paid off when it comes due. Ideally, the Housing Authority wants to control sufficient debt so that it can always achieve a debt + $1 outcome.

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116 Norfolk Street

PROJECTED VALUE OF TAX CREDITS, CASH FLOW, AND TAX LOSSES TO AN INVESTOR PARTNER
UNDER THE ASSUMPTION A CORPORATE INVESTOR CONSUMMATES THE TRANSACTION
For the Period March 31, 2022 through December 31, 2038

Year	Amount	Taxable Income (Loss)	Tax Savings (Expense)	Annual Federal Low Income Tax Credit	Total Tax Savings (Expense)	Investor Cash Flow	Annual Benefit Fr P/ship	Cum Benefit	Cum Net Investment
2022	2,062,688	0	0	0	0	0	0	0	2,062,688
2023	1,031,344	0	0	0	0	0	0	0	3,094,032
2024	1,031,344	(1,473,836)	309,506	998,641	1,308,147	0	1,308,147	1,308,147	2,817,230
2025	16,501,507	(1,682,000)	353,220	2,104,784	2,458,004	0	2,458,004	3,766,151	16,860,732
2026	0	(1,586,810)	333,230	2,104,784	2,438,014	0	2,438,014	6,204,165	14,422,718
2027	0	(1,585,793)	333,017	2,104,784	2,437,801	0	2,437,801	8,641,966	11,984,917
2028	0	(1,592,848)	334,498	2,104,784	2,439,282	0	2,439,282	11,081,248	9,545,635
2029	0	(1,595,173)	334,986	2,104,784	2,439,770	0	2,439,770	13,521,018	7,105,865
2030	0	(1,597,391)	335,452	2,104,784	2,440,236	0	2,440,236	15,961,254	4,665,629
2031	0	(1,604,997)	337,049	2,104,784	2,441,833	0	2,441,833	18,403,087	2,223,796
2032	0	(1,613,427)	338,820	2,104,784	2,443,604	0	2,443,604	20,846,691	(219,808)
2033	0	(1,622,684)	340,764	2,104,784	2,445,548	0	2,445,548	23,292,239	(2,665,356)
2034	0	(1,632,910)	342,911	1,106,143	1,449,054	0	1,449,054	24,741,293	(4,114,410)
2035	0	(1,644,097)	345,260	0	345,260	0	345,260	25,086,553	(4,459,670)
2036	0	(1,656,395)	347,843	0	347,843	0	347,843	25,434,396	(4,807,513)
2037	0	(1,669,807)	350,659	0	350,659	0	350,659	25,785,055	(5,158,172)
2038	0	(1,684,492)	353,743	0	353,743	0	353,743	26,138,798	(5,511,915)
	20,626,883	(24,242,660)	5,090,958	21,047,840	26,138,798	0	26,138,798		

Capital account goes negative in Year 13. Early exit?

PROJECTION OF INVESTMENT RESULTS UPON SALE OR DISPOSITION
OF PROJECT ON DECEMBER 31, 2038

		$1 Over Mortgage Balance
Original Investment		(20,626,883)
Cumulative Tax Losses (Income)		24,242,660
Cumulative Cash Flow		0
Capital Account Prior to Sale		3,615,777
Sales Proceeds		0
(Gain) Loss on Sale		(3,615,777)
(Gain) Loss on Sale		(3,615,777)
Tax (Savings) Expense	21.00%	759,313

Potential exit tax liability at Year 15

Capital Account Analysis

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RESIDUAL ANALYSIS (YEAR 15)

Year	3.00% Rental Income	3.00% Other Income	3.00% Vacancy & Bad Debt	3.00% Operating Expenses	3.00% Management Fee	3.00% Resident Services	3.00% Replacement Reserves	Net Operating Income	Permanent Loan Debt Service	Cash Flow	(To) Reserve From Reserve	Cash Flow
2024	717,744	1,945	(32,298)	(222,065)	(89,393)	(174,836)	0	201,097	0	201,097	0	201,097
2025	1,543,011	2,105	(69,436)	(783,530)	(92,074)	(180,081)	0	419,996	(337,678)	82,318	0	82,318
2026	1,573,872	2,147	(70,824)	(807,036)	(94,837)	(185,484)	0	417,839	(337,678)	80,161	0	80,161
2027	1,605,349	2,190	(72,241)	(831,247)	(97,682)	(191,048)	0	415,322	(337,678)	77,644	0	77,644
2028	1,653,509	2,256	(49,673)	(856,184)	(100,612)	(196,780)	0	452,516	(337,678)	114,838	0	114,838
2029	1,703,115	2,324	(51,163)	(881,870)	(103,631)	(202,683)	0	466,092	(337,678)	128,414	0	128,414
2030	1,754,208	2,393	(52,698)	(908,326)	(106,740)	(208,764)	0	480,074	(337,678)	142,396	0	142,396
2031	1,806,834	2,465	(54,279)	(935,576)	(109,942)	(215,027)	0	494,476	(337,678)	156,798	0	156,798
2032	1,861,039	2,539	(55,907)	(963,643)	(113,240)	(221,477)	0	509,311	(337,678)	171,633	0	171,633
2033	1,916,871	2,615	(57,585)	(992,552)	(116,637)	(228,122)	0	524,590	(337,678)	186,912	0	186,912
2034	1,974,377	2,694	(59,312)	(1,022,329)	(120,136)	(234,965)	0	540,328	(337,678)	202,650	0	202,650
2035	2,033,608	2,775	(61,091)	(1,052,999)	(123,740)	(242,014)	0	556,538	(337,678)	218,860	0	218,860
2036	2,094,616	2,858	(62,924)	(1,084,589)	(127,453)	(249,275)	0	573,234	(337,678)	235,556	0	235,556
2037	2,157,455	2,944	(64,812)	(1,117,127)	(131,276)	(256,753)	0	590,430	(337,678)	252,752	0	252,752
2038	2,222,178	3,032	(66,756)	(1,150,641)	(135,215)	(264,456)	0	608,143	(337,678)	270,465	0	270,465
Total	26,617,788	37,284	(880,999)	(13,609,713)	(1,662,607)	(3,251,766)	0	7,249,987	(4,727,492)	2,522,495	0	2,522,495

	2039						
NOI Less Ground Lease Payment	2039	537,010	537,010	537,010	537,010	537,010	537,010
Cap Rate		8%	7%	6%	5%	4%	3%
Value		6,712,623	7,671,569	8,950,164	10,740,197	13,425,246	17,900,328
Reserves		0	0	0	0	0	0
O/S Debt							
Permanent Loan		4,582,164	4,582,164	4,582,164	4,582,164	4,582,164	4,582,164
CHA Acquisition Loan		2,334,815	2,334,815	2,334,815	2,334,815	2,334,815	2,334,815
CHA Program Loan		2,567,385	2,567,385	2,567,385	2,567,385	2,567,385	2,567,385
CAHT Loan		11,842,927	11,842,927	11,842,927	11,842,927	11,842,927	11,842,927
DHCD Loan		1,748,266	1,748,266	1,748,266	1,748,266	1,748,266	1,748,266
Deferred Developer Fee		-	-	-	-	-	-
Ground Lease		-	-	-	-	-	-
Total O/S Debt		23,075,556	23,075,556	23,075,556	23,075,556	23,075,556	23,075,556
Excess/(Shortage)		(16,362,933)	(15,403,987)	(14,125,392)	(12,335,360)	(9,650,310)	(5,175,228)

Do we have enough debt at various cap rates to support $1 above debt purchase? Yes we do.

Residual Value Analysis

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Year 15 Planning Is at Play When Selecting Partners

- In your offer to investors and lenders, a Housing Authority should clearly and specifically express its goals for Year 15 outcomes. Language used by Cambridge on previous solicitations include:
  - **No, or very limited, cost upon repurchase**. "PHA would like the structure to be designed so that the exit taxes and other costs for PHA or one of its affiliates to repurchase the property at the end of the LIHTC compliance period (or to purchase the Selected Investor's membership interest either at the end of the LIHTC credit period or during the compliance period) is **zero or minimal**. Specifically, it is PHA's **strong preference for an exit strategy** that includes all of the following: a FMV option with no add-on for exit taxes, a Right of First Refusal (ROFR) at the minimum price permitted under Section 42, and an option to acquire the Investor's membership interest at FMV with the appropriate discounts for lack of control and lack of liquidity. It is the PHA's strong preference that the transaction be structured so that the exit strategy of a FMV option with no add-on for exit taxes **yields a purchase price equivalent to assumption of all existing debt at the end of the LIHTC compliance period**. "
  - **Avoiding Bad Partners.** "To ensure a seamless implementation of the exit strategy, it is PHA's strong preference that the operating agreement of the Tax Credit LLC **prohibit transfers** of member interests (other than to an affiliate of the Selected Investor) without the Managing Member's prior written consent, to be granted or withheld in its sole discretion. Such a consent right will allow PHA to avoid transfer of the Selected Investor's membership interest to a party who might not be amenable to a cooperative execution of the exit strategy."

Other Early Strategies to Help Year 15 Outcomes

- Other strategies that can help with Year 15 outcomes beneficial to a Housing Authority include:
  - **Housing Authority Debt and/or Accrual of Ground Lease or Other Payments to the Housing Authority**. Housing Authority debt is something that is controlled by the Housing Authority an ensures a strong role or potentially controlling role in Year 15 negotiations.
  - **Adding Operating Expenses Above the Line**. Seek a provision to allow for above-the-line funding of certain expenses when the Property reaches a specific benchmark (e.g. debt service coverage ratio at 1:20). When the benchmark is met, then certain expenses are added like ground lease payment, resident services, extraordinary maintenance can be moved above the line. Adding operating expenses this way also can have a positive impact on the Year 15 appraisal of the property.
  - **Negotiating for the Release of the Operating Reserve.** CHA always seeks a provision which would establish that all reserves as the property of the LLC and not partnership and include a release of substantially all of the operating reserves in the later years of the tax credit compliance period to fund extraordinary maintenance and/or tenant services. You do not want the value of the operating reserves to come into play at Year 15 or be something the investor seeks to benefit from.

Protections for CHA and its Residents within Ownership Structure

- CHA uses various tools to protect the long-term interest of Housing and its Residents with the LIHTC Ownership Structure:
  - **Long-Term Control of the Land.** CHA keeps its long-term interest in the property by leasing the ground and property to the new LIHTC ownership entities but retaining the underlying ownership interest. Within the leasing documents are provisions that specify CHA rights.
  - **Operating Agreement**. The operating agreement specifies that the CHA through one of its non-profits will be responsible for the day-to-day operation of the tax credit LLC. The operating agreement also specifies CHA will be the management agent for the property. CHA seeks to limit its removal in either role only if CHA's performance constitutes bad faith, willful misconduct, gross negligence or breach of fiduciary duty.
  - **Right of First Refusal and Purchase Option Agreement**. This agreement is executed at the financial closing and provides a first refusal/purchase option for the property to be purchased by CHA or one of its affiliated non-profit at the end of the LIHTC compliance period.
  - **Housing Authority Mortgages.** CHA typically provides financial support to the project which is done in the form of mortgages. Any purchaser other than the CHA would need to pay-off or assume these mortgages to purchase the property interest.
  - **Affordability Restrictions.** CHA ground lease and mortgages include provisions that the property be operating in accordance with certain requirements and continue to serve low-income individuals and families.

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Year 15 Know Your Repurchase Options

- Section 42 makes certain options available to repurchase. Not every option is available in every transaction so you need to make sure what is included in your transaction.
- **Understand the differences between your options. Some of the typical ones are:**
  - ❖ <u>Right of First Refusal (ROFR)</u> – This is often the ability to purchase the physical building at a formula price (debt + exit tax). Good terms are: extended period to perform, definition that offer from third party is a bona fide offer, reference to affordability and occupancy restrictions impacting value
  - ❖ <u>Option to Purchase</u> – This is often the ability to purchase the physical building at a market price. Good terms are: potential for early exit, clear process for determining fair market value, reference to affordability and occupancy restrictions impacting value
  - ❖ <u>Option for Assignment of Partnership Interests</u> – This is the ability to accept the investor's limited partners' interest in the partnership. (Do not forget about a special limited partner if there is one in your deal). This can be the easiest, less expensive way to repurchase the property.

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Year 15 Analysis Is a Yearly Exercise

- Once you close:
  - **Gather deal documents, make sure they are digitized, and locate them in an accessible location for legal, fiscal, asset management and property management.** Everyone needs to reference back to original documents from time to time.
  - **Prepare a deal summary and deal book for distribution within the Housing Authority to the key stakeholds.** Provide a summary to the agency describing the key elements of the transaction, the anticipated outcomes and the supporting documents associated with outcomes.
  - **Review the deal annually.** Is it preforming as expected? Is cash flows higher or lower? What is happening to the capital account? Have there been any legislative actions that impact deal performance? (Example – 2017 Trump Tax Cuts and Jobs Acts changed depreciation and lower the tax rate which impacted already closed deals!)
  - **Year 15 involves the entire team** – Legal, fiscal, property management, asset management.
  - **Year 15 needs to be actively managed!** Deals are always performing better or worse than their closing projections. The sooner a problem is identified, the more options you have to address or fix, or to execute an early exit if beneficial.
  - **Make sure you give yourself enough time to execute.**

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Year 15 (*or 10 if Early Exit*) Is Coming – Time to Get Strategic

- **<u>Several years before you anticipate taking action</u>**, review how the building has been performing financially. Are there issues or concerns that need to be considered as you work towards the most beneficial outcome for the Housing Authority. Information to consider include:
  - ✓ What's the status of the investor's capital account?
  - ✓ Who owns or gets the operating, replacement, and/or other reserves?
  - ✓ Have cash distributions been occurring or has there been a build up of cash at a property?
  - ✓ Is there a way to spend down cash or reserves? Do you need to?
  - ✓ What's the physical conditions of the building – how much work is needed in the short to medium term (which could affect the value of the building)
  - ✓ What is the value of the building, both market, per your documents and as encumbered? And what is the value of the partnership?
  - ✓ Review and assess what are your purchase options and rights given performance of the investment?
  - ✓ How do you exercise your rights? You need to understand the steps to execute
  - ✓ What consents are needed and what is the timing needed to get the consents?
  - ✓ When should you reach out to start discussions?

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Year 15 Additional Considera-tions

- ✓ Be sure to identify the receiving entity, one that will be best suited to hold the interest or ownership. Make sure the receiving entity is a good fit and does not cause issues with other deals or future deals.
- ✓ Be sure to do projections on tax basis, not GAAP
- ✓ If there is any unpaid developer fee, there could be basis issues. Look to resolve in advance.
- ✓ Income tax – The General Partner or Managing Member entity can be a taxable entity. Make sure you know.
- ✓ Unrelated business taxable income (UBTI) – some transactions can be taxable event to a non-profit. Be sure to seek advance.
- ✓ Getting the consents is time consuming and will likely involve legal review and assistance. Plan accordingly.
- ✓ After the transfer, it may be beneficial to terminate the partnership.

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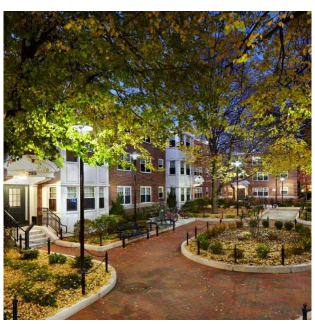
Questions?



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