Preserving and recapitalizing Affordable housing today

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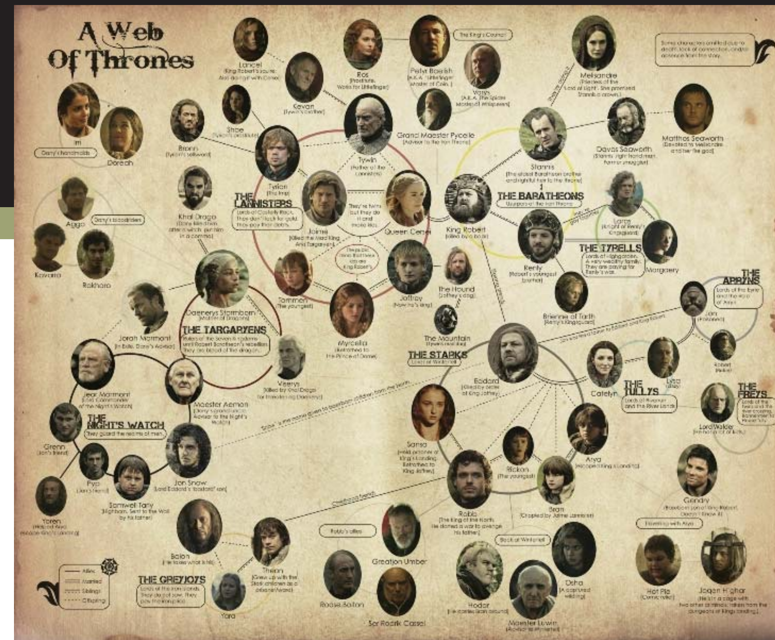
The Game of Homes

Introducing the four types of players

- The Game of Homes
  - "Deals are devices to produce fees; housing is a useful byproduct"
- The major 'families'
  - Allocators
  - Developers (for-profit, non-profit)
  - Investors
  - Intermediaries

- LIHTC comes in two flavors:
  - Allocated ('9%' = 55% of TDC)
  - Volume-cap ('4%' = 25% of TDC)
- The state of play today:
- 'Winter is coming'
  - LIHTC is scarce
    - Volume cap is plentiful
  - Deals are scarce
  - Syndicators are plentiful (even surplus)
  - Developers are plentiful (even surplus)



You can't tell the players without a scorecard; and even then it's confusing

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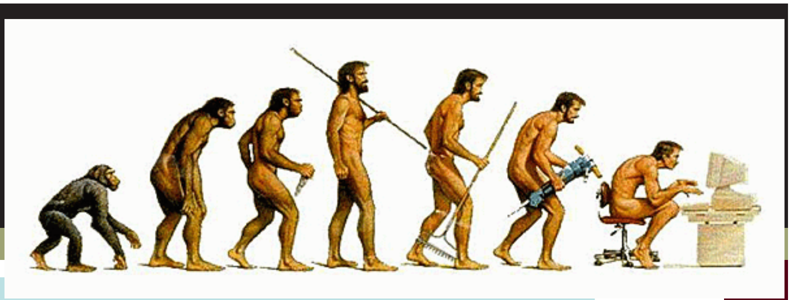
The LIHTC life-cycle
Do it again in 15 years?



"Do the numbers work? I could do with a refresh"

Phase (years, months)	**Elements**
1. QAP (Y_0–24_m)	State sets rules and scoring criteria Administrative requirements, set-asides, priorities
2. Awards (Y_0–18_m)	State scores applications, choose the winners Issues a 'reservation letter' (expires if not used timely)
3. Syndication (Y_0–15_m)	Developer secures equity commitment from investor Via syndicator, direct, or 'private label'
4. Closing (Y_0–12_m)	Developer closes construction loan, soft debt, investor admission, buys land, starts construction
5. Occupancy (Y_0)	Certificates of Occupancy, move in income-qualified tenants, Partnership's accountants issue form that starts LIHTC flowing
6. Operations (Y_0–Y_{10})	Annually, partnership tax return includes schedule of amount of LIHTC allocable to each partner
7. Recapture (Y_{10}–Y_{15})	No more LIHTC flows, clawback declines to 0%
8. Recapitalize (Y_{10}–∞)?	Starting Y15 + 1 day, do it all over again? Extended use agreement can complicate

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LIHTC transaction structuring

A perfect fit that becomes less and less perfect as time goes on

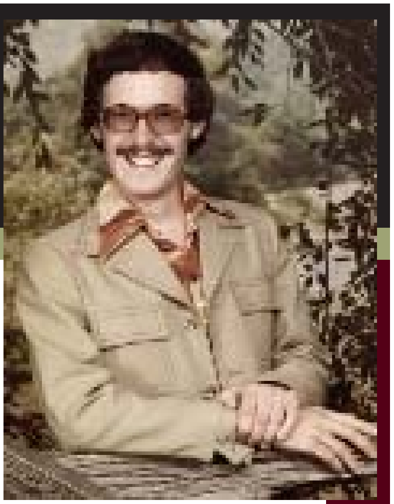

Photo of our founder when he started the company

- Affordable finance is conventional ‘with a chaperone’
  - Government stands as parental protector
    - Lower-income customer needs lower rent
    - Lower rent → lower NOI → lower hard debt → ‘makeup’ subsidy
  - Government resources counterbalance lost economic value
    - Soft debt (lower rate, accruing, pay only ‘if come’)
    - Soft equity (equity whose return comes from tax savings, not economics)
    - Income subsidy (boost rent-paying power of extremely low income)

- Three magic intervals: 10-15-30+
  - 10 years: Delivery of tax credits
  - 15 years: Risk of recapture of tax credits (if violate rules)
  - 30 years: ‘Extended use period’ (aka the zombie stage of life)
    - Some go out 55+ years

- Properties are custom-financed at inception
  - Capital stack is complicated (multiple sources)
  - Each junior lien limits options
  - By Year 15, it’s time for new custom-tailoring

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Preservation is never permanent
Properties are always coming and going

People come, people go … nothing ever changes

- "Properties need a financial face-lift every 10 to 15 years"
- Change the physical configuration
  - Properties age (faster or slower than expected)
  - Apartments become functionally obsolete
    - New technologies (broadband, microwaves) → new systems needed
    - New household configurations (smaller, non-traditional)
- Change the rules: Affordability is never permanent
  - Markets rise and fall
- Change the players: Partners' interests, incentives diverge
  - Investors consume tax credits, become demotivated
  - General partners age, change focus, change capacity
  - Partners come, partners go; list of things that become obsolete
- Change the capital stack
  - Loans accumulate or amortize

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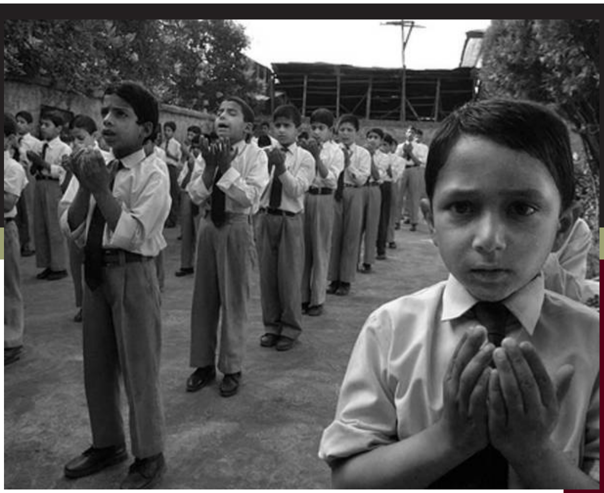
Affordable housing's orphan properties
(Hint: they need adoption)



Please sir, I need new LIHTCs

- **Distinguishing features**
  - Physical obsolescence
  - Overly engineered financing
  - Suffocating use agreements
  - Toothless enforcement mechanisms (after Year 15)
  - Misaligned sharing arrangements
  - Demotivated ownership (old LPs)
  - Barriers to exit (soft debt)

- **Types of orphan properties**
  - Legacy public housing (RAD)
  - Section 202 elderly
  - FmHA (RHS) 515 'formerly rural'
  - HUD older assisted
  - Post-preservation
    - ELIHPA, LIHPRHA, M2M
  - Post-Year-15 LIHTC

- What does it take to be their guardian?
  - **Legitimacy**
  - **Capability**
  - **Durability**
  - **Scalability**
  - Power to restructure monetary incentives (at intake)
  - Ability to win new resources
    - Volume-cap bonds (4% LIHTC)
    - Allocated LIHTC
    - New soft debt

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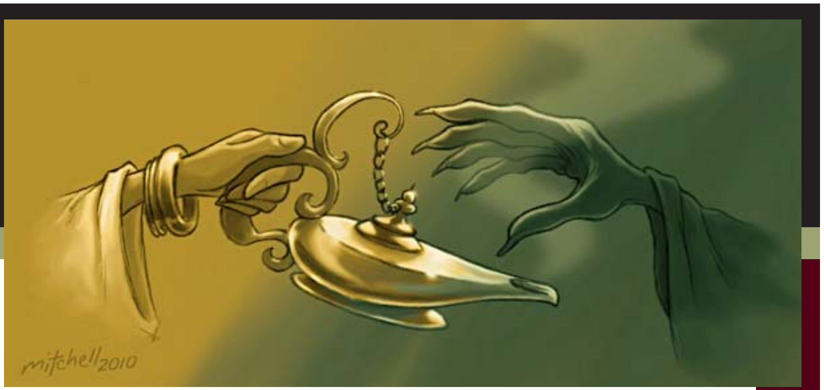
Preservation as acquisition

One owner's exit is another owner's entry



"New tax credits for old!"

- Why do it?
  - Acquire using Other People's Money
  - Provide an exit for investors
  - Capture a new round of development fees
  - Improve the GPs' ownership/ sharing
- How to do it?
  - Sales price to current owners
    - Deferred sales price, deferred development fee
  - Partner with housing authorities
  - 'Buy trouble' – take over problem properties
- 'Find juice' (resources to close the cost-value gap)
  - Volume-cap bonds → 'free' LIHTC (as-of-right, 4% not 9%)
  - Real estate tax abatements
  - Operating savings (especially from non-economic owners)
- Popular sources of raw material
  - Old public housing (via Rental Assistance Demonstration, RAD)
  - Very superior old properties (reaching Year 40)
    - § 202, Never-preserved (§ 221d3, 236)
  - Post-preservation (ELIHPA, LIHPRHA)

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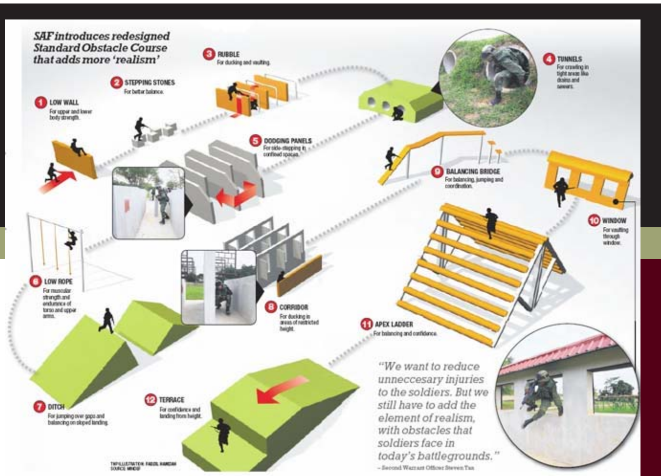
Challenges

“If it were easy, everybody would be doing it”



Whatever doesn’t kill you earns you a development fee … maybe

1. Securing a ‘viably priced’ deal
   - Bad deals are plentiful … good deals scarce
   - Anything listed via brokers will be priced up
   - Buy contrarian: find real risk < perceived risk
2. Winning the LIHTC
   - QAP award cycles move slowly → long-fuse options needed
   - Even the best proposals win only 1 in 3 times
     - And to file an application costs ~$150k of third-party costs/ overhead
   - The winners have to pay for the 2 losers
3. Selling the LIHTC
   - Syndicators are plentiful, negotiating can be bewildering
4. Finding the soft debt
   - LIHTC by itself is seldom enough
   - Soft debt providers can be arbitrary
     - Comply with everybody’s rules (meaning worst of worst)
5. Maintaining a cash development fee
   - Allocators have limitations on development fee allowed
   - Not all of it will be paid in cash over development phase

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Questions?

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