Appraisals: Why They Matter in LIHTC Transactions

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Appraisals: Why they matter in LIHTC transactions

ABA Appraisal Panel

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Introduction

Value – Why Does it Matter

What is the Question?

What Is an Appraisal?

Who is Asking?

Lender
Developer
Investor
We Start With Markets

Community

Subject
Components of an Appraisal - Agenda

We Match The Appraisal Question to the Methodology
Process = Approaches to Value

- LIHTC
- RAD
- Section 8
- Aq-Rehab
- RE Taxes

Rent / Expenses

Cap Rates

- NOI / AMI Restrictions
- Aq-Rehab issues
- Land lease methodology

Land Values

- GP vs LP
- Partnership agreements
- Concern vs Disposition

Divided interest valuations

We Match The Appraisal Question to the Methodology
Process = Approaches to Value
Start with Rents

• Which Rent?
  • Market Rent
  • PRAC/RAD/Sec 8
  • LIHTC

• Are max rents achievable in my market?
• How are LIHTC rents calculated (abridged version)?
• What does the future hold for LIHTC rents?
HUD Rent Calculation

1. Estimated of Median Family Income
   • HUD 2016 ACS (3-year lag)
2. Calculation of High Housing Cost
   • Compares HUD FMR to determine HH Cost
3. Calculation of Low Housing Cost
   • Compares HUD FMR to determine Low Housing Cost
4. Compares area to State Non-Metro Median Family Income
   • Designed to “bump” lower income areas to the state non metro
5. Ceiling or floor adjustments
   • Year over year can only grow 10% or fall 5%

<table>
<thead>
<tr>
<th>Type</th>
<th>Income Limit Calculation</th>
<th>Non-metro Counties</th>
<th>Metropolitan Areas</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Limits based on 50% of local median family income</td>
<td>579</td>
<td>383</td>
</tr>
<tr>
<td>2.</td>
<td>Limits based on State non-metropolitan median family income level</td>
<td>1292</td>
<td>123</td>
</tr>
<tr>
<td>3.</td>
<td>Limits increased to the amount at which 35% of 4-person family’s income equals 85% of the 2-bedroom 40th percentile rent</td>
<td>15</td>
<td>31</td>
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<tr>
<td>4.</td>
<td>Limits decreased to the greater of 80% of the U.S. median family income or the amount at which 30% of a 4-person family’s income equals 100% of the 2-bedroom 40th percentile rent</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>5.</td>
<td>Limits floored if they would be less than 95% of last year’s limit</td>
<td>19</td>
<td>11</td>
</tr>
<tr>
<td>6.</td>
<td>Limits capped if they would otherwise increase by more than twice the increase in the National Median Income (i.e., would be more than 110% of last year’s limit)</td>
<td>67</td>
<td>77</td>
</tr>
<tr>
<td>7.</td>
<td>TOTALS</td>
<td>1973</td>
<td>625</td>
</tr>
</tbody>
</table>
Income Limits Growth 2018-2019 (4-Person 50%)

- Income Limit grew over 4% from 2018 to 2019 (unweighted average)
- Only 426 of 4,765 counties saw a decrease year over year!
- California, for example, had one county whose income limits decreased.
Rent and Income Limit Growth

• What does this mean for LIHTC valuations?

• Can we predict rent and income limits beyond 2019?

• Can I explore the map myself?
Review of Income Averaging and RAD

• Admissions are intended to be below 50% and below 80% of AMI
• Income averaging can change dynamic of overqualified tenants
Next – Expenses (LIHTC)

- Novogradac tracks LIHTC Expense growth and publishes them annually.
- The report studies trend by region, unit type, tenancy, age, and more.
- This is changing with recent oversight recommendation.
- Some highlights include...
Overall LIHTC Expenses, Year over Year change

Expenses grew 2.3% from 2016 to 2017.

Source: Novogradac
Real Estate Taxes

• Real estate taxes showed surprising growth from 2016-2017. Why?
  • increased assessed values in states like Washington, which saw a significant increase in real estate taxes because rising local property values, can increase the sample’s real estate tax expenses;
  • a change in the dataset—in 2017 Novogradac added a significant number of new records to the dataset from Maryland and Virginia, two states with high real estate taxes; and,
  • a change in how properties are assessed, or re-assessed upon sale.
• Non profit purchasers?
In 2017, LIHTC properties’ overall expenses grew 2.3 percent while their revenue grew 2.7 percent. This difference in growth resulted in the largest year-over-year NOI increase (3.3 percent) seen in eight years.
Finally - Capitalization Rates

- What no LIHTC Data?
- Other Data Sets
- What About Future Value or Prospective Value
  - Value at Mortgage Maturity
    - Future Value
    - Risk in terms of location
    - What will change
Components of the Whole

Land Value
- How do we Value Land?
- Highest and Best Use (HBU)
  - Physically Possible
  - Legally Permissible
    - Bundle of Rights
    - Density Bonuses
    - Encumbrances!!!
  - Financially Feasible
    - Uh oh
  - Maximally Productive
    - Not Really
- Methodology – no longer income driven

Land Lease
- Fair Rent?
- Capital Lease?
- Impact upon Value?
- When are we valuing this?

What about Acquisition
Rehab versus New Construction?
Divided Interest Valuations

- GP vs LP
- Partnership agreement stipulations
- Growing concern vs disposition
Value of LIHTC Property at (or near) Year 15

Purpose of Valuation -
Review Partnership Agreement

Dissolution of Partnership
Buyout of Interest (GP, LP)
Partnership Agreement Valuation Stipulations – Who, What, How
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
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)
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.
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