Low-Income Housing Tax Credit Asset Management

By Allen Feliz, Tax Credit Asset Management, LLC

THE FEDERAL LOW-income housing tax credit (LIHTC) program has been one of the most successful affordable housing finance programs in our nation's history. Since its creation in 1986, the program has financed more than two million units. Even as LIHTC industry participants grapple today with the decline in investor demand and the broader housing market downturn, tax credit properties continue to outperform other real estate asset classes – featuring the lowest foreclosure rate.

Today's challenges, however, should remind us that the program's success should not be a cause for complacency. To preserve the current and future value of LIHTC properties, including their health as communities for their residents, expert, efficient and focused construction and asset management are necessary. This article provides an overview of LIHTC asset management, describes other pertinent services that asset managers provide, and outlines how asset management is done effectively and the different options for performing this function.

Overview of Asset Management

LIHTC asset management, in a nutshell, is the process of overseeing a property's financial performance, physical condition and compliance with applicable regulations to help investors, lenders, state agencies and other capital providers receive the expected benefits and manage their risk. This service involves monitoring, information gathering and reporting, and analysis and risk management, including problem-solving.

Asset management for LIHTC properties closed and managed by syndication firms is usually performed by the syndicator, for the benefit of the investors. In the absence of a syndicator (i.e. direct investor), the investor may perform the asset management using in-house staff, or hire a third-party asset manager. Some state housing credit agencies perform asset management for projects they have financed.

Syndicators or third-party asset managers are paid by investors, through reserves established during the initial investment and/or from revenue from the properties. Deals can be initially structured to pay asset management fees, either from available cash flow or as an operating expense.

LIHTC asset managers typically work for the benefit of investors or other capital providers and report to them monthly or quarterly. These reports summarize the current and expected operational performance and physical condition of the properties and their compliance with tax credit rules and other regulations. Reports also include information for each property on the following: current debt service coverage, occupancy, and cash reserve levels; curb appeal; review of annual audited financial statements and tax returns; role of the participants in meeting their obligations under the governing

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documents; assessment of the management agent's proficiency; and the asset manager's recommendations for rectifying any problems.

Asset managers receive property-level information from each project's general partner and management agent. When issues arise with a property, the asset manager often works directly with the general partner, on the investor's behalf, to develop solutions to address the immediate issue and ensure the asset's long-term viability.

Value of Asset Management

Effective asset management during the stabilized phase, as during the construction period, depends in part on strong data collection and risk management systems. A seasoned staff and up-to-date systems can help preserve property values and prevent costly scenarios. For instance, many LIHTC properties operate with insufficient resources and marginal or negative cash flow. Although local general partners provide good ground-level attention, they often need more help. An asset manager can provide that assistance, mainly by overseeing or addressing issues related to every major operational aspect of the project (e.g., market, tenant, physical).

LIHTC properties with good asset managers are more likely to experience strong operational performance, thereby benefiting the equity investors, lenders, project general partners and the communities served.

Poor asset management can be costly. For instance, an asset manager's lack of understanding of the LIHTC placed-in-service rules can cause the loss or delay of tax credits to investors. Similarly, failure to detect leasing problems can lead to project deficits that threaten the viability of the investment.

The strength of the asset manager depends in large part on experience, data systems and management procedures. The absence of deep expertise in real estate finance, tax credits or multifamily engineering will limit the asset manager's ability to analyze construction progress and operational performance, and to detect issues early and address them appropriately.

Construction and Lease-Up Phase

Asset management usually begins once the project's financing has closed and construction is ready to start, and continues until the end of the property's 15-year tax credit compliance period or when the investor disposes of its interest in the asset.

Construction monitoring entails month-to-month management of the costs and timing of development by the construction asset manager. Various inherent risks during the construction phase include the potential for divergence from the originally underwritten tax benefit schedule or final determined tax credit amount.

An effective construction monitor will help a project achieve completion on time and budget, enabling investors to obtain their expected economic benefits and the developer its full development fee.

In addition to monitoring the construction schedule and budget to ensure that the project's funding sources and uses remain in balance, the duties of the asset manager during this phase include the following: (1) reviewing construction draws and approving equity releases; (2) overseeing project lease-up; (3) providing guidance towards the conversion to the permanent mortgage and the receipt of IRS Forms 8609 for the project; (4) initial monitoring of the project for compliance with LIHTC rules; and (5) presenting and/or implementing recommended actions to resolve any issues.

Stabilized Phase

The construction phase generally ends, and the stabilized period begins, once a project achieves a sustained level of occupancy and debt service coverage (e.g., through three consecutive months); receipt of 8609s; and the permanent mortgage conversion occurs.

An effective asset manager ensures that the property's value is preserved throughout the compliance period, by diligent and periodic oversight and by providing and implementing recommendations for remedial actions if the project is underperforming. The main objective during stabilization is to make sure that properties perform according to initially underwritten operating and tax benefit projections. This work requires a comprehensive set of procedures designed and (with the investor's approval) implemented by the asset manager. These procedures include the following: (1) a monthly or quarterly review of operating statements, including annual review of audited financial statements; (2) LIHTC compliance monitoring; (3) site visits (allowing examination of the property's physical condition and on-site manage-

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ment); and (4) a review of the general partner's economic health.

Other Pertinent Services

Where necessary or requested, LIHTC asset managers also provide other pertinent services, including workouts, recapitalizations and dispositions.

Workouts demand intense management due to the severity of the issues involved and the complex financial structuring of many LIHTC transactions. Additionally, asset managers with expertise in dispositions can assist investors in negotiating the terms of dispositions, by performing a thorough analysis of all relevant financial information and partnership documents.

Maximizing an asset's residual value or turning around a troubled deal are services best provided by firms that understand the unique aspects of each transaction; that have experience working with general partners, management agents, lenders and regulatory agencies; and can propose practical and innovative solutions.

Options for Provision of Asset Management

As previously mentioned, LIHTC asset management is usually performed by a syndicator or a direct investor.

Several factors can guide a capital provider's decision to the best approach for receiving asset management services.

Cost is perhaps the most important factor. Other important criteria include the size of the portfolio of properties, geographic concentration, and number of local general partners. The operational performance of the assets should also be examined, since underperforming deals require more time and resources to monitor.

An organization's staffing and budget are factors as well.

Capital providers with well-performing portfolios and a manageable workload can benefit from building or maintaining asset management capacity through an in-house approach. Firms without asset management but a budget to acquire experienced personnel and efficient systems are also well-positioned to build internal capacity.

For many capital providers, however, faced by increased

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DEVELOPER PROFILE

Rob McCready Is Pushing to Get Stimulus-Assisted Projects to Construction

AN AVID BIKE RIDER, Midwest tax credit developer Rob McCready is pedaling faster than ever in his day job.

In addition to his usual task of securing the multiple funding sources needed for new low-income housing tax credit (LIHTC) projects, he's also having to try to speed construction of a number of pending developments to meet looming deadlines imposed by the federal Tax Credit Assistance Program (TCAP) and credit exchange program.

"There's this big push between now and the next four months to get under construction," says McCready, one of three co-presidents and principals of MetroPlains, LLC, along with Vern Hanson, Jr. and Randy Schold. MetroPlains has a handful of TCAP and credit exchange-assisted projects in five states in what McCready calls the "big push" phase. Developers must expend 75% of TCAP funds by 2/16/11 and 100% by 2/16/12. Credit exchange-assisted projects must generally be completed by 12/31/10, though a new policy change provides some leeway. Some of MetroPlains' projects also have 2008 credits or the syndicators have closed with investors and want to place their equity by year-end.

St. Paul, Minn.-based MetroPlains, LLC is the development group that has evolved since doing its first project in 1978. Since then it has developed around 90 properties. MetroPlains LLC specializes in developing LIHTC projects, evenly split between new construction jobs and renovations of existing historic buildings with federal housing and historic rehabilitation credits.

The company is currently working on projects – rural, urban,

Rob McCready

suburban – in Minnesota, North Dakota, Iowa, Wisconsin, and Oklahoma, and Kansas.

"We try to do three or four projects a year throughout the Midwest," says McCready. "The average size is between 30 and 40 units."

New construction projects are typically infill developments. One example is Vantage Flats, a $7.8 million, 37-unit development completed in 2008. Located in Minneapolis and green-certified,

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demands for timely and accurate information on their portfolios, yet constraints on head count, outsourcing is a practical alternative.

Capital providers such as investors, lenders and state agencies looking to outsource asset management have several choices today. The options include tax credit syndicators, which have LIHTC expertise and often already have asset managers and advanced data systems; independent tax credit experts or firms that focus exclusively on asset management, and are free of any obligations that might create conflicts of interest or cause distractions; and commercial real estate asset management firms, which can bring scale and real estate experience, although they may not have the required housing credit expertise.

Effective asset management is essential for the preservation of asset values, investor risk management, the long-term success of the LIHTC program and the health of our communities. Effective asset oversight is ultimately a function of expertise, efficiency and focus. Regardless of which asset management approach a capital provider selects, it is well worth the cost in problems avoided and value maintained.

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