

## insights

TYPES NOT MAPPED YET January 12, 2015 | TTR not mapped yet | Mark V. Bossi

# The valuation process for LIHTC projects in financial distress: Part I

**Note:** This post is part of a [continuing series on the Credit Report Blog](#) on the subject of workouts and bankruptcies involving low-income housing tax credit (LIHTC) projects.

In a [previous post](#), we wrote about the importance of a secured lender understanding the value of its collateral in a workout or bankruptcy involving a low-income housing tax credit (LIHTC) project. In this post and a subsequent [Part II post](#), we'll delve into the subject of valuation in greater depth.

### Why is valuation important?

In any workout or bankruptcy, it is important to understand the value of a lender's collateral, because the value of the collateral will largely determine the amount of the lender's recovery. This is particularly true in a workout or bankruptcy involving an LIHTC project because under the federal LIHTC program, once a project is placed into service, all senior debt of the project owner must be non-recourse to the partnership and its partners. In other words, the lender's only recourse will be to the project itself.

If the project is in bankruptcy, the valuation of a lender's collateral can be even more important. Under Section 506(a) of the Bankruptcy Code, a lender's claim is bifurcated into (i) a secured claim in an amount equal to the value of the lender's interest in its collateral, and (ii) an unsecured claim for the balance of the debt owed to the lender. A borrower/debtor may "cram-down" a plan of reorganization on the lender if it pays the lender the full amount of its secured claim, with interest, over a reasonable period of time and satisfies various other requirements set forth in the bankruptcy code (which, in most cases, do not require the payment in full of the lender's unsecured claim). In short, the amount that a lender receives in a bankruptcy is also largely determined by the value of its collateral.

### What is unique about the valuation of an LIHTC project?

There are four unique aspects of an LIHTC project that impact valuation when compared to the valuation of a typical real estate project.

1. An LIHTC property is burdened by rent and occupancy restrictions of a Land Use Restriction Agreement (LURA), which limit to whom units in the project may be rented and the amount of rent that may be charged.
2. An LIHTC project benefits from federal (and in some cases state) tax credits that can be used to reduce the tax liability of the owner on a dollar-for-dollar basis, provided the property remains in compliance with the rent and occupancy restrictions.
3. While a lender can likely foreclose away the LURA and convert the property to a market-rate property, the lender (and any subsequent owner) must still honor a three-year "decontrol period" during which rents may not be increased for existing tenants.
4. Many LIHTC projects benefit from and are burdened by a Section 8 Housing Assistance Payments (HAP) contract that may, or may not, survive a foreclosure and resale of the project.

It is imperative that a valuation of an LIHTC property addresses each of these unique aspects of an LIHTC project.

## Who is qualified to appraise an LIHTC project?

The [Uniform Standards of Professional Appraisal Practice](#) (USPAP) contains guidelines for the appraisal of real estate. Licensed appraisers are compelled to comply with USPAP through state law. Advisory Opinion 14 of USPAP specifically addresses the appraisal of subsidized housing and states that “the competency required to appraise subsidized housing extends beyond typical residential appraisal competency.” The Advisory Opinion warns that the appraiser must understand the programs, definitions, and relevant tax considerations of subsidized housing, as well as local market conditions, and supply and demand characteristics of subsidized housing. In addition, the appraiser must be aware of anticipated changes that may affect the durability of the benefits and restrictions to subsidized housing projects and understand the interpretation and enforcement of subsidy programs.

In short, great care should be taken in the selection of an appraiser with experience in appraising LIHTC projects.

## Should remaining tax credits be included when valuing an LIHTC property?

It has been argued that tax credits are intangible property that should not be considered when determining the value of a lender's lien on an LIHTC project. However, three different appellate courts\* have been presented with this issue and have concluded that the value of an LIHTC project must include consideration of the value of any remaining tax credits available for the project. In the *Lewis and Clark Apartments* case, the 8th Circuit Bankruptcy Appellate Panel states:

“[T]ax credits - like a low property tax rate or good schools - are a benefit which accrues only to those who have an ownership interest in the apartment complex itself. For that reason, we hold that those credits and the accompanying restrictions have an effect on the amount that a willing buyer would pay to purchase the real estate: i.e., its value.”

Unfortunately, no court has provided any clear guidance regarding the methodology to be used in valuing the tax credits or for determining the contributory value of the tax credits on the project itself. Rather, these courts have left it to the discretion of the bankruptcy courts to hear evidence and determine what “due consideration” should be given to the value of any remaining tax credits.

Not only have the courts failed to provide any clear guidance as to how appraisers are to value remaining tax credits, there is no “industry standard” or uniform methodology for determining such value. [Fannie Mae's Appraiser Engagement Instructions](#) (Form 4825) states:

- “The Appraiser or third-party valuator should consider the current secondary market for tax credits and consider what incremental value, if any, would be added to the price of the Property by virtue of the Tax Credits remaining. The Appraiser or third-party valuator needs to determine what net proceeds would result from a re-syndication or resale of the Property. Because there is no one ‘industry standard’ for how appraisers make such a determination, the Appraiser or third-party valuator shall set forth factors utilized in reaching his/her determination.”

Check back to the Credit Report Blog for [Part II](#) of our two-part series on the valuation of low-income housing tax credit projects, including some of the unique challenges it raises when compared to traditional commercial appraisals.

\**In re Creekside Senior Apartments*, 477 B.R. 40 (6th Cir. BAP 2012); *In re Lewis and Clark Apartments, L.P.*, 479 B.R. 47 (8th Cir. BAP 2012); *In re Sunny Slope Housing Limited Partnership*, U.S. District Court for the District of Arizona, Case 2:11-cv-02579-HRH at Dkt. 92.

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