Understanding Low Income Housing Tax Credits: How to Secure Equity Investments and Evaluate Syndication Options

Disclaimer: Corporation for Supportive Housing (CSH) is providing this information to assist interested organizations to develop a general understanding of the supportive housing development process. CSH is not rendering legal, accounting or other project-specific advice. For expert assistance, please contact a qualified professional.

Low-Income Housing Tax Credits are an important source of financing for the development of supportive housing projects. This memo is intended to provide a basic understanding of how tax credit equity is accessed and how to evaluate proposals from potential investors. However, this is a very technical and sometimes esoteric area of housing finance. Appropriate advice from qualified legal and financial professionals should be sought in connection with any tax credit transaction.

This guide covers several areas – how to identify potential equity investors, how to solicit proposals from them, and how to evaluate the proposals and select an investor. It does not assume any background in the field of tax credits, or for that matter, any housing finance background.

Introduction to Low-Income Housing Tax Credits:

Low-Income Housing Tax Credits (referred to as tax credits hereinafter) are incentives for private individuals and corporations to invest in low-income housing. The Tax Reform Act of 1986 created this program, which provides a dollar-for-dollar credit against income taxes owed to the federal government, as opposed to tax deductions, which reduce taxable income. In exchange for these benefits, individuals and corporations invest in low-income housing, paying less than a dollar for a dollar's worth of credit (thereby creating a return on their investment). The tax credit program uses tax policy, rather than federal expenditures, to induce investment in affordable housing. The federal cost is in the form of foregone revenues to the U.S. Treasury, rather than being applied to the federal budget.

Non-profit housing developers have become quite sophisticated in accessing tax credits for their projects. Developers can then sell the credits to investors, and use the proceeds as equity in the project – often providing between 30%-50% of the total development costs. The tax credits are offered by state agencies, typically state housing finance agencies, which receive an allocation of credits from the federal government on a per-capita basis. In 2002, the tax credit is $1.75 per capita (per resident), and beginning in 2003, the per capita allowance will increase at the rate of the Consumer Price Index. States distribute the tax credits through an annual application process that is guided by their "Qualified Allocation Plan" (or "QAP"), which can be obtained from the state tax credit agency. And by law, 10% of their annual allocation must be reserved for non-profit applicants. States often have other set-asides that could include special needs housing (check the QAP to see).

Note: This document is included within the *Development and Finance* section of CSH's *Toolkit for Developing and Operating Supportive Housing*, which is available at www.csh.org/toolkit2.

Projects that receive tax credits must meet certain eligibility requirements that include:

- At least 20% of the units must be affordable to households with incomes below 50% of the area median income (AMI); or alternatively, 40% of the units must be affordable to households below 60% of the AMI;
- Rents can be no greater than 30% of the household income, based on the size of the housing unit (regardless of household size occupying the unit);
- For rehabilitation, the total cost must be at least $3,000 per tax credit unit, or 10% of the project's unadjusted basis (see explanation of basis below);
- Must be rental housing – homeownership is not eligible;
- Financing source must be eligible (e.g., grants, most federal subsidies and tax-exempt bonds are not eligible sources); and
- Most rental housing types are eligible, however for all housing types other than SRO and transitional housing, there must be a lease for at least six months; SROs are eligible so long as the unit is rented on a month-by-month basis or longer. Transitional housing is eligible if the project assists homeless persons find permanent housing within 2 years, provides a kitchen and bath in each living unit and provides supportive services. Note that housing occupied exclusively by students, and dormitories, are not eligible for tax credits.

There are many more detailed requirements and exceptions for qualifying for tax credits, but the ones listed above are the basic ones. Do not rely on this list to determine eligibility, since it is not definitive. Instead, we recommend that you consult a tax credit guide or professional tax credit advisor.

The amount of equity that can be raised for a project is a function of how much "qualified basis" there is in the project. "Basis" is simply the project costs that are subject to depreciation – like construction, appliances and traditional soft costs (e.g., professional fees). Costs that are not depreciable, such as the land value or operating reserves, are not includable in basis. Also not included in basis are costs that are funded by ineligible sources such as grants and federal subsidies. The "qualified basis" is calculated by multiplying the total eligible basis by the percentage of tax credit units in the project (or their percentage of square footage if this is lower). The portion of tax credit units is known as the "applicable fraction." For example, if the "total eligible basis" is $1,000,000, and the "applicable fraction" is 80% (80 out of 100 units are tax credit units), then the "qualified basis" would be $800,000.

The outcome of the above calculation (qualified basis) is then multiplied by the appropriate tax credit rate. This rate is either 4% or 9%, depending on the financing source and structure. Most supportive housing projects will use the 9% credits. The exact tax credit rates fluctuate, and are published monthly by the federal government. An additional 30% "basis boost" is also offered in neighborhoods that are considered high cost (see HUD list of qualified census tracts).

The qualified basis times the tax credit rate equals the amount of annual tax credits for which the project is eligible to apply. And depending on the amount that investors are willing to pay for a tax credit dollar, you can translate the annual amount into a net equity number that the project would likely receive.

- Total Eligible Basis x Applicable Fraction = Qualified Basis
- Qualified Basis x Tax Credit Rate = Annual Tax Credits
- Annual Tax Credits x 10 (years) = Total Value of Tax Credits
- Total Value of Tax Credits x Investment Per Tax Credit Dollar = Net Equity Investment

Tax credits have a restriction that the project remains as very low-income housing (i.e., meeting the original income qualifications) for 15 years. Projects must conduct annual income certifications to ensure compliance with these requirements. The IRS may audit the project for compliance, and if it is found to be out of compliance, there could be a recapture of benefits from the investors.

Projects can be structured so that the non-profit sponsor can purchase the project at the end of the compliance period, and continue to operate it as affordable housing long-term. This is the standard structure of the Enterprise Community Investment (ECI) and the National Equity Fund ("NEF") deals, where the sponsor is given an option to buy at a cost of remaining debt plus exit taxes.

This is just a very basic explanation of how tax credits work. There are a number of excellent resources that should be explored by Program Officers who want to learn more or to get answers on specific issues. One of the best publications is "Tax Credits for Low Income Housing" by Joseph Guggenheim (Simon Publications – 301-320-5771), which can be ordered in loose-leaf notebook form with 3 updates per year (recommended). Another new resource is The Enterprise Community Investment's "Tax Credits 101" tutorial offered at its website. This covers an explanation of how the program works, sample projects, underwriting, tax credit administration and financial structuring issues, all written in a very accessible style.

The structure for tax credit investments for non-profit developers is typically the formation of a limited partnership. This partnership includes the investors or "Limited Partners", whose liability is limited to the extent of their investment, and a "General Partner", usually a for-profit subsidiary of the non-profit sponsor. The General Partner has full responsibility for the management of the project, and assumes the liability as well. Ownership of the project is generally divided where the Limited Partners have 99.9% interest and the General Partner has .01% interest. In this way, the tax benefits flow to the Limited Partners, who can use the credits.

How to Identify Potential Equity Investors – Who's Out There?

The term "equity investor" is being used in this guide to refer to both a "syndicator" and a "private placement." A syndicator is an entity, which raises funds, often on an annual basis, from investments by various corporations or individuals. Tax credits are most advantageous to corporations, since the benefits to individuals are limited by passive loss rules. The syndicator creates an equity fund that invests in a number of tax credit projects by buying the tax benefits (the tax credits, the annual losses, and the amortization and depreciation) in exchange for the equity. A syndicator can either invest in a number of projects through "blind pools" or it can invest in specific projects. In blind pools, the various corporations and individuals that invest in the syndicator's fund do not know which specific projects the fund itself is investing in, and defers to the syndicator to underwrite and complete due diligence for them. The equity fund spreads its investments over a number of projects that meet their underwriting standards.

"Private placement" refers to the practice of a corporation investing directly in a particular tax credit project, rather than through an equity pool. In this way, the institution places the investment in its own portfolio, and receives all of the tax benefits. Increasingly, banks have made private placements, since these qualify for Community Reinvestment Act (CRA) credit, and can raise their profile in the project. Moreover, the tax credit investment offers a competitive return, and is seen as a case of "doing well by doing good."

Syndicators

There are a host of syndicators that raise equity for tax credit projects, including those established by non-profit national intermediaries, state and city-level funds, private for-profit entities and even online equity pools. Probably the most definitive list of equity investors, both syndicators and private placements, can be found in "Tax Credits for Low Income Housing" by Joseph Guggenheim (see Tab 6).

The two leading equity pools sponsored by national non-profit intermediary organizations are the "Enterprise Community Investments", established by Enterprise Community Partners, and the "National Equity Fund" (NEF), initiated by the Local Initiatives Support Corporation (LISC). Both raise their investments from large corporations, and place their equity in non-profit sponsored low-income housing projects, often organizations with which they have ongoing relationships. These sources of equity are particularly attractive to non-profit sponsors since they offer competitive pricing, and structures that are sympathetic to non-profits, including the right to purchase at the end of the 15-year compliance period. In the event that the General Partner experiences problems during operation, these syndicators know how to work with non-profit organizations, and should show more forbearance than typical syndicators. The fact that the funds were established by organizations whose missions are aligned with non-profit developers should have some qualitative value for supportive housing sponsors. Moreover, ESIC and NEF understand how to underwrite supportive housing projects (including an appreciation for the services component), whereas most syndicators lack experience in this type of housing, and may have a long "learning curve."

In a number of states and cities, non-profit organizations have created equity pools that only invest in their particular state, locality or region. These funds raise their investments from corporations that want to see their funds targeted geographically, and may tap smaller local companies that are not interested in a national focus. Presently, there are about 18 state-level funds in operation, and about 6 to 12 local funds. One of the advantages of these funds is that they can often provide technical assistance to the sponsors, and help them access other sources of public financing as well. They tend to focus their work on non-profit developments, and are an excellent resource if one exists in your area, and should be on any list of potential investors.

There are dozens of private syndicators that raise investments from corporations and individuals, and place their equity in both for-profit and non-profit low-income housing projects. Each fund has its own set of legal documents and its own underwriting standards, which can make it difficult to select a compatible firm. Non-profit sponsors of supportive housing would be well advised to only select syndicators that have an established reputation for working with non-profits in the location of the project. Joe Guggenheim's manual offers a list of private syndicators that principally invest in non-profit projects, and these should be given special consideration by supportive housing sponsors. Informal networking with colleagues in the non-profit housing development field is perhaps the best

way to identify these entities. Be wary of syndicators that solicit your organization through mailings to tax credit applicants or conference attendees, unless these are "known quantities."

There is an on-line business that offers tax credit projects to investors that are members of the service (you can find it at http://www.ehousingcredit.com/). Essentially, this service auctions the project to the highest eligible bidder (investor), providing the most equity, and a fee is paid to the company if you use this investor. This approach has several drawbacks, including the fact that it limits potential investors (only members of the service are included), and does not necessarily consider qualitative issues in evaluating competing offers. Moreover, it is not clear what screening an investor must go through in order to bid on projects, so the quality and experience of investors may be uneven. To the extent that non-profit sponsors use this service, they must do their own due diligence on the investors to make sure they are qualified.

Private Placements

Private placements are usually made by corporations that manage their own investment portfolios, and want control over where and how their investments are made. These direct investments in tax credit projects should not be overlooked, since they can generate more net equity as they may not have to pay the syndicator's fee if they underwrite the project in-house. Among the more active corporations making direct private placements is Fannie Mae, which also invests in equity pools. Sponsors of supportive housing projects may want to contact leading banks in their communities to see whether they purchase tax credits. As noted earlier, banks are becoming major players in tax credit investment, as these qualify for CRA credit.

How to Solicit Proposals from Equity Investors:

There are a number of situations where non-profit sponsors will seek equity from only one investor, and will not solicit competitive proposals. Many non-profit sponsors will work exclusively with a particular syndicator because they have an ongoing relationship that they value. This is common with organizations that work with the Enterprise Community Partners or the LISC, and use their respective affiliated equity partners (ECI and NEF). In other cases, the sponsor is required to use the equity fund that is part of a publicly funded program (e.g., The New York Equity Fund/HPD program in New York City). Also, the absolute highest equity raise (investment dollars per tax credit dollar) is not always essential, since the highest raise may simply reduce the public funding or tax credit allocation, and not directly benefit the project. This is true where an average raise is sufficient for project feasibility, and a higher raise would generate equity in excess of the amount of sources needed.

However, when sponsors need to maximize the equity investment for the project, or when they have no historic relationship with a syndicator, it makes sense to seek several competitive proposals or bids. The competitive dynamic should be able to yield higher equity investments and/or better terms than "sole source" investments. Of course, the sponsor will want to let the equity investor know that they are not the only party being considered, in order to create a competitive atmosphere.

It is best to limit the list to several pre-qualified equity investors, with which the sponsor would be comfortable working. Sponsors should contact each of the potential investors to find out what information they require in order to evaluate a tax credit project.

Information to Provide to Equity Investors:

There is no standard format for a "request for proposals' from equity investors, however, the type of information typically included would be:

General Project Description: A general project description should be prepared, that addresses: Construction type, number of units, total square footage, total cost, financing structure, location, access to amenities, status/timeframe, use of tax credits, supportive services provided, target population, and sponsor/service provider's track record.

Status of Financing: Potential equity investors want to know that the project has secured or is likely to obtain financing commitments for the balance of project funding required. This should include both construction and permanent financing sources, a description of the status of the commitment, contact names/phone numbers, and any commitments or term sheets issued.

Appraisal and Market Study: Projects using the acquisition credit must provide an appraisal to substantiate the value, though this may be deferred until the due diligence phase if it is not available. Market studies may also be required for tax credit projects that include unsubsidized rents (to ensure that the market is present and that absorption rates are acceptable). Market studies that were submitted with the tax credit application may be acceptable. For more in-depth information on market studies, see "How to Structure and Evaluate Market Studies."

Conceptual Architectural Drawings and Zoning Analysis: Architectural plans should be included, and must be at least at the conceptual or schematic stage. Evidence of any required design review approval should also be included if available. Closely related, a zoning analysis that shows that the project complies with applicable zoning, and can be built "as-of-right" (or that a variance has been secured) should be part of the submission.

Development Budget: A "sources and uses" budget that shows all projected development costs and sources of construction/permanent financing should be included. Since tax credit equity is a source, the required amount should be indicated as a source (supported by the tax credit analysis).

Tax Credit Analysis: This provides a rationale for the amount of investor equity included in the development budget, including basis assumptions and raise requirements. These assumptions will all be reviewed by potential investors, who may underwrite differently than the sponsor (e.g., may not arrive at the same qualified basis).

Operating Pro Forma and 15-Year Cash Flow Projections: Sponsors should submit rental income (and commercial or other income if applicable) assumptions, as well as maintenance and operating expense assumptions. A 15-year cash flow projection should also be provided, including all income/expense trending assumptions and demands on operating reserves.

Sources of Rental Subsidies and Status: Most supportive housing projects will include some form of rental subsidies (e.g., Section 8, Shelter Plus Care, HOPWA), and the specifics of these subsidies should be described, including: type of subsidy (e.g., project-based, tenant-based), the term of the subsidy, source of subsidy (e.g., HUD McKinney, local housing authority), amount of the subsidy (total and monthly levels), and the current status of the subsidies. If already awarded, evidence should be provided.

Information on the Sponsor, Architect, Attorney, Accountant, Consultant, Property Manager and Contractor: While the potential equity investor is evaluating the merits of the project, it is also underwriting the capacity and qualifications of the development team to undertake the development and to operate it successfully during the 15-year compliance period. Resumes and comparable projects should be submitted for the sponsor and development team members. The sponsor should also submit its most recent audited financing statement. If the project will be using an outside property manager, their credentials should also be included. The general contractor is often not identified at this stage; however, if it has been selected, their qualifications must be part of the RFP. Otherwise, this will be part of the due diligence requirements from the investors.

Evidence of Site Control: Sponsors should provide evidence that they have control over the project site, preferably in the form of outright ownership, a contract of sale or option to buy. If the form of site control is only a letter of interest or intent from the owner, this will be considered far less reliable by potential equity investors, and they may not be interested until firm site control is secured. If the site has not yet been acquired, information on projected closing dates and how the purchase will be financed should be submitted.

Project Timeline: The projected timeline for the tax credit project is of interest to the investors, since they need to know how it fits into their own fund timing (and different funds may have different return requirements and terms).

Evidence of Tax Credit Allocation: The potential investor will want to review evidence that the sponsor has received a tax credit allocation. This may not be available at the time that the RFP is submitted, however, it will certainly be part of the investor's due diligence requirements. If the project has already received a tax credit award, it makes the project more attractive since it is more reliable than one with a pending application for credits.

Due Diligence Requirements:

In addition to the items described above, the equity investor will have a list of "due diligence" items that must be submitted and reviewed before the investment can be approved. Other items may be conditions of the commitment, and need to be satisfied by equity closing (e.g., contractor's letter of credit or approval of construction drawings). Typically due diligence requirements include such items as:

- Insurance for Sponsor, Architect and Contractor
- Evidence of Letter of Credit or performance bond
- Acceptable General Contractor credentials
- Final architectural plans/specifications
- Building Permit
- Evidence of equity, if applicable

Information to Request from Equity Investors:

The information outlined above is what a typical potential equity investor will need in order to evaluate your project and prepare a proposal. The request for proposals should also cite the information that you will need from investors to evaluate their proposals. It is important to state this in the RFP so that you have sufficient information to compare the proposals side-by-side. The proposals from potential investors should include at least the information below:

Net equity amount: The net equity to be invested (not the gross), including a pay-in schedule. This should be net of all fees paid to the syndicators.

Bridge Loan Requirements: What are the assumptions for bridge loans against the equity, if needed? Is the investor providing the bridge loan, or is the sponsor or third party expected to finance a bridge? If the investor is providing bridge financing, the interest amount should be broken-out.

GP Capital Requirements and Terms: The amount of the General Partner capital requirements, and the terms.

Guarantees/Adjusters: What guarantees is the investor requiring of the sponsor, and what are the caps on amounts or time limits of the guarantees? The policy on adjusting the equity in the event that the credit allocation changes should be stated.

Distribution of Cash Flow: The distribution of any excess cash flow should be detailed, as well as the methodology for an "incentive management fee", if proposed.

Sale Terms: The terms for a sale to the sponsor should be described, including the specific methodology for determining the sales price, and whether the sponsor has a right to purchase at the end of the 15-year compliance period.

Reserve Requirements: Different investors have different operating reserve requirements, and these should be included in their proposals.

Sample legal documents: While not all investors will be willing to release their sample legal documents at this stage, sponsors may wish to involve their Attorneys in the evaluation by having them review these documents.

Investor Qualifications: Include firm resumes, including a list of tax credit equity investments, non-profit projects that the firm has invested in (with contact information), and the names and resumes of the principals.

How to Evaluate Syndication Options:
Syndication bids must be analyzed on both a net equity basis as well as on a more qualitative basis. While sponsors are often very interested in the "bottom line" (i.e. which bid offers the most equity), there are other issues, including guarantees, sales terms and reserve requirements, which should be considered carefully as well, as they will determine the risk level to the non-profit sponsor.

A. Net Equity Comparison - Making an "Apples-to-Apples" Comparison:

The first step in evaluating syndication options is to compare the equity offered by each investor on an "apples-to-apples" basis. To do so, two main questions must be addressed:

1) What is the net equity to the project (i.e. have the investor fees, costs and reserves been backed out of the quoted equity number)?
2) What is the pay-in structure/timing of the equity payment?

Investor Fees, Costs & Reserves:	In evaluating syndication options it is important to compare the net equity of the options. Net equity (as opposed to gross equity) is the amount of proceeds available to the project after all of the investor's fees, costs and reserves have been subtracted out. NEF takes out these fees, costs and reserves from its quoted equity number, but some other investors provide quotes which include these costs and then charge them to the project development budget. To compare bids on an "apples-to-apples" basis, each bid letter must be read through carefully to determine if such costs are included in the quoted equity number. If it is unclear whether these costs have been subtracted, contact the firm for more detail.
Timing of Equity Payment:	Once all bids are net of additional costs, they may still not be comparable if the investors are assuming different pay-in structures for the project. Some investors provide all of the equity up-front, so no bridge loan is needed; some investors base pay-ins on when the funds are needed; and some investors make equity pay-ins tied to certain benchmarks. ESI, for example, often uses a 3-pay structure (i.e. 1/3rd at partnership closing, 1/3rd at construction start and 1/3rd at construction completion or qualified occupancy) based on when the sponsor needs the funds. Therefore, bids need to be "present valued" to a common pay-in structure. "Present value" places all pay-ins into current dollars. The sponsor will usually know approximately when the project will need equity funds in which case the bids should be present valued to the sponsor's indicated pay-in structure. Otherwise, a pay-in structure must be assumed and all bids should be present valued to it.

B. Comparison of Other Critical Deal Points

Critical deal points can be divided into six main categories. The chart below is subdivided accordingly. These categories are:

1) Bridge Loan Requirements;
2) General Partner Capital Requirements and Terms;
3) Guarantees/Adjusters;
4) Distribution of Cash Flow;

5) Sale Terms; and
6) Reserve Requirements

Bridge Loan Requirements:	Some investors provide bridge loans; some investors arrange third party bridge loans; and some investors require the sponsor to arrange its own bridge loan financing. ECI and NEF generally provide bridge loan financing and their bids will be net of the interest on this bridge loan. Many investors, however, do not provide bridge loans, putting the additional burden of securing bridge loan financing on the sponsor. Furthermore, the cost of this bridge loan financing can vary, and this can substantially reduce the net equity that is available to the project.
GP Capital Requirements and Terms:	The sponsor is often asked to make either a capital contribution or a loan to the project, perhaps from its developer's fee, to close a capital funding gap (i.e. when available permanent financing is less than total development costs). If the investor requires that the deficit be made up for by a capital contribution, then the sponsor will not be paid back. However, if the investor will allow the deficit to be made up for by a sponsor loan (or "deferred developer's fee"), then the sponsor will be able to recoup its investment in the project. In fact, if it is structured as a deferred developer's fee, it must be paid back from cash flow within 10-12 years. It is important to note what the terms of this loan are, such as the maturity date and the interest rate.
Guarantees / Adjusters:	Tax benefit guarantees and tax credit adjusters are mechanisms for investors to recoup benefits that are not delivered or are delivered later than originally anticipated. This could occur if the tax credit allocation is lower than expected, or if the total eligible basis projections are not met. Until all equity is paid into a project, it is quite likely that guarantees and adjusters will be invoked. After all equity is paid into a project, it is more difficult to collect on guarantees or adjusters. Typically, syndicators use guarantees while private placements use a combination of guarantees and adjusters. A guarantee will stipulate that if certain requirements or targets are not met, a portion of the equity must be paid back if all of the equity is already paid in. Collecting on guarantees involves legal action and it can be very difficult to get money back once it

	is invested in the project. Since institutions that do private placements typically don't pay in equity to the project until later on, they use adjusters, a mathematical formula which changes or adjusts the equity that the investor will pay to the project if certain requirements or targets are not met. Adjustments to the equity pay-in are often seen and can substantially decrease the equity amount that the sponsor expected to receive. Every investor will require that the GP be liable for certain things, including tax benefit shortfalls, unanticipated operating deficits and development cost overruns. It is important to note whether these guarantees or adjusters are limited to a maximum cap and time period. If the investor does not limit the liability of the sponsor on these overruns or shortfalls, in a worst-case scenario, the sponsor's financial condition could be compromised for life. Therefore, such offers should be considered carefully. The chances of such tax benefit shortfalls or cost overruns happening will vary from project to project as well as from investor to investor, as each investor will use different assumptions in their underwriting.
Distribution of Cash Flow:	Once all operating expenses, required debt service and reserve requirements have been paid, investors will require that excess cash flow be distributed in a certain way.
Servicing Fees / Excess Cash Flow	The investor may not require any annual payment or may require anywhere from an annual servicing fee to all excess cash flow beyond debt service and reserve requirements. Although it is difficult to estimate the cost of these fees since it is hard to estimate a project's excess cash flow, these disbursements can be significant and should be viewed as cash flow that could have been used by the project or GP.

Partnership Management / Incentive Fees	Investors may allow certain payments to be made to the sponsor for successfully managing the project. These payments typically take the form of a partnership management fee or incentive management fee. A partnership management fee is a payment to the GP, usually of a pre-set amount. On top of the partnership management fee, some investors will allow the sponsor to collect an incentive management fee if the project achieves certain reserve level requirements..
Sale Terms:	
Right of First Refusal	Some investors will offer the GP the right of first refusal on the sale of the property. It is important to note if the investor does offer the GP the right of first refusal, as this effectively gives the GP the first right to purchase the property in year 16. As many non-profit sponsors intend to continue operating the projects beyond the 15-year partnership term, having the right of first refusal is very important.
Sales Price	Investors will generally use one of two methods to calculate the sales price of the property. ECI's and NEF's standard sales price is outstanding debt plus exit taxes to the investors. Other investors require that the property be sold for the greater of outstanding debt plus taxes or market value at time of sale. At what price the GP can purchase the property for must be compared as a more costly sales price could use up funds that could otherwise have been used to benefit the project or sponsor.
Distribution of Sale Profit Proceeds	If the sponsor chooses not to purchase the property and it is sold to a third party, the profits are divided between the investor and GP after outstanding debt and taxes are paid. However, how the remaining proceeds are distributed can vary from investor to investor. Many investors require that their original investment be repaid before any proceeds go to the GP while other investors, including ECI, make no such requirement. Typically, proceeds from the sale of the property are split between the GP and investor either 50%/50% or 1%/99%.

Reserves:	Reserve requirements can vary greatly from investor to investor and are a tricky thing to compare. While a smaller up-front operating reserve requirement means more funds for development costs and while smaller annual payments to reserves can mean more excess cash is available to the GP, it must not be assumed that "smaller is always better". It is imperative that projects have adequate reserves in place, and a conservative approach to sizing reserves can be a benefit to the sponsor and the project's long-term viability. In addition, unspent operating reserves can also be a source for acquiring the project at the end of the compliance period. The three main reserves, which should be focused on, are the operating reserve, the lease-up reserve and the replacement reserve.
Operating Reserve	To assess if the operating reserve sizing is reasonable, the underlying assumptions, including rent trending, operating expenses trending and unit vacancies, should be studied. Each investor will use different assumptions so it is important to make sure the assumptions are reasonable. Another thing to look for with respect to the operating reserve is how and when it is required to be funded. Will it be funded by equity pay-ins or will bridge financing need to be found to fund it?
Lease up Reserve	The lease up reserve is often sized according to how quickly the sponsor believes it can rent up units. Make sure that the number of months specified for lease-up is reasonable, as some investors may be too aggressive here in order to reduce reserve requirements.
Replacement Reserve	Annual contributions to a replacement reserve are usually required by all investors, but in varying amounts. Again, these should be compared and some conclusion drawn as to a reasonable annual contribution. An annual replacement reserve contribution is usually 2%-3% of gross rental income or $150-$250 per unit per year. Typically, replacement reserve contributions will be higher for rehabs than for new construction. Having annual contributions that are too high will divert cash flow from the project and/or GP; having annual contributions that are too low could result in inadequate funds to repair or repaint units as needed and could hurt the project's long-term viability.

Once you have completed the review of the proposals from potential equity investors, you should contact them to address any terms or assumptions that are unclear or have been left out. With this comparable information in hand, you can enter it into a matrix chart to evaluate the proposals side-by-side, remembering to adjust pay-ins to present value dollars (remember-apples-to-apples). You may also want to assign weights to different criteria. For example, if you absolutely need the highest net equity, than this may receive the highest weight. However, if the tax credit "raise" beyond some minimum threshold is simply going to reduce your subsidized loan amount, you may want to place more weight on the profile of the investor (e.g., non-profit intermediary vs. for-profit investor). Ultimately, the sponsor organization's board of directors will need to determine the appropriate criteria for evaluating the competing offers.

One of the advantages of using a competitive approach is that you can try to leverage better terms (otherwise known as playing the investors off of each other). This is commonly done, and is expected by the investors. An example of this would be that you really want to work with ECI, but their net equity is 4 cents lower than the best for-profit offer. You can try to use this to leverage a higher equity amount from ECI, since they do have some flexibility in this area. You can also let ECI and NEF, which are very similar entities, compete for your project (assuming they are both interested), thereby improving the terms for the sponsor. Of course, even if you are securing the equity directly from only one investor, you can still negotiate for better terms. T hey just don't have the same incentive to improve the terms when it is an exclusive arrangement.

Once you have completed the negotiations and have agreed to the final business terms of the investment, you should ask the investor for a commitment letter that spells out all of the specific substantive terms. Make sure that the tax credit attorney reviews this letter before executing it, since there may be language that needs to be further negotiated.