From: David Levy
To: Koch, Jim
Subject: Fwd: CDI - Surrounding State Cap Rates
Date: Thursday, November 08, 2018 10:09:13 AM

Source: Sales reports from LIHTC Advisors – 2014-2017 Sales Data - Unloaded Cap Rates

South Dakota: 7.93 percent
North Dakota: 9.85 percent
Kansas: 7.11 percent
Iowa: 8.75 percent
Nebraska: 7.33 percent
Omaha: 8.05 percent
Lincoln: 8.59 percent

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Baird Holm LLP

September 14, 2018

Mr. David C. Levy
Baird Holm LLP
1700 Farnam Street
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RE: **Tax Assessment Consultation – Nebraska Capitalization Rate Committee**

Dear Mr. Levy:

Thank you for choosing CohnReznick LLP ("CohnReznick") to perform professional services for Baird Holm LLP (the "Company"). At your request, we have analyzed certain inputs and assumptions that have been utilized by the Rent-Restricted Housing Projects Valuation Committee in setting the "Overall Rate" ("OAR" or "Cap Rate") for rent-restricted (or "affordable") housing properties in the State of Nebraska, for the purposes of tax assessment by local County assessors, following procedures established by Legislative Bill 356.

By way of introduction, CohnReznick is the largest affordable housing advisory and assurance/tax practice in the country, working in the industry since its inception. Having a track record of more than 35 years assisting the industry, we service thousands of developers, syndicators and investors across the country and are active in national and regional associations and industry coalitions that support and create successful affordable housing.

Our research included review of the documents available on the "Annual Reports of the Rent-Restricted Housing Projects Valuation Committee"[1] which included information for the 2015, 2016 and 2017 Reports: Income and Expense Statements from LIHTC projects, Equity Return Rates, Meeting Minutes, Calculated Rates and Portfolio Information. Our research also included extraction of sales data from CoStar Comps, discussions with affordable housing market participants, and interviews with Sarpy County Assessors.

Our understanding of the procedures of the committee is to utilize the band of investment technique in the calculation of an applicable Overall Rate, where inputs for Mortgage Constants, Loan to Value Ratios, and Equity Return Rates are used in combination to predict an overall return for a specific real estate investment.

The technique is illustrated and included in the "2017 Rent Restricted Data FINAL Analysis – Lori J.xlsm" spreadsheet. The inputs include a capital stack of 60% Equity and 40% Mortgage, a Mortgage Constant of 7.2% and an Equity Return of 5.4%. The capital stack was derived from the average of 300+ "deals" within the State of Nebraska. The mortgage constant was similarly averaged from mortgage constants calculated from these deals (and included in the same referenced spreadsheet). The calculation is presented, as follows:

[1] http://www.revenue.nebraska.gov/PAD/rent-restricted_housing/annual_reports/annual_reports.html

"2018 Estimated Cap Rate"

Overall State				
Mortgage	x	Rm		
40%		0.072	=	0.02874
Equity	x	Re		
60%		0.054	=	0.03240
				0.06114
		Called		**6.1%**

Recommendation No. 1: In our opinion, the Rent-Restricted Housing Projects Valuation Committee incorrectly estimated the cost of debt by averaging the mortgage constants of the average of first-tier lien loans in aggregate, with the averages of the second-tiers, the average of the third-tiers, and the average of the fourth-tier lien loans. If the Committee instead were to equally weigh the mortgage constants for all loans over all tiers, the average mortgage constant would be larger. For example, some second-tier lien loans included in the analysis that have no interest rate and no term result in a mortgage constant of zero, which skews the cost of debt significantly downwards. **If all loans were being equally weighted, cost of debt would be 7.9% (70 basis point increase from 7.2%).** This is more consistent with Ms. Johnson's analysis as of November 10, 2016, "For 187 projects analyzed, [Ms. Johnson] had an average 7.9423% mortgage constant."[2]

Recommendation No. 2: The Equity Return ("Re") noted in the previous table was "hard-keyed" in a 5.4%. Earlier minutes for this Committee indicated supported Equity rates of 6.5% (2015), lowered to 5.0% (2016) "calculated using a 15-year after tax return as presented in the data from Midwest Housing Equity Group ("MHEG")," but increased to 5.4% per the December 1, 2017 Minutes. In our opinion, the Rent-Restricted Housing Projects Valuation Committee incorrectly estimated the cost of equity by only taking into consideration the after tax 30 and 40-year required returns (5.45% and 5.46%, respectively) from the information provided for the 2017 Fund 48 for MHEG. However, the Committee is using the pre-tax debt and the County Assessor is capitalizing a pre-tax Net Operating Income. It is logical to use the pre-tax cost of equity which indicates an increase from 5.45% up to 8.38% (for 30-years), and 5.46% up to 8.4% (for 40-years) - **a 300 bps consideration and upward adjustment.** Using the pre-tax average of the 30 and 40-year return as the cost of equity (at 8.4%), and using the calculated

[2] Committee Minutes as of November 10, 2016

split of 40% debt and 60% equity, the capitalization rate would now be 8.2%, as follows:

"2018 Estimated Cap Rate" - Adjusted

Overall State				
Mortgage	x	Rm		
40%		0.079	=	0.03160
Equity	x	Re		
60%		8.40%	=	0.05040
				0.08200
		Called		**8.2%**

Furthermore, we expect that the different tier classes of loans would receive different weights, considering varying priority of repayment. Priority position debt has less risk than second, third or fourth positions; the data could be re-weighted and analyzed to provide a stronger indication of expected returns and resulting constants, most likely higher than the 7.9% constant applied here.

Recommendation No. 3: In past minutes, the Committee has considered relative market forces in its estimate of the capitalization rate. Market conditions do change from year to year, and sound appraisal techniques dictate analysis of the capital and real estate markets to determine their impact on investment decisions, as well as prices identified in the market.

Due to the Tax Cuts and Jobs Act of 2017, which reduced the corporate tax rate from 35 percent to 21 percent, there has been an analogous decrease for the demand for tax credits. With low demand for tax credits, theoretically, the investor would require a higher rate of return on their investment; thus, the overall capitalization rate should also go up in parallel. Given the Committee's consideration of external market forces in previous meetings, <u>the estimated 2018 capitalization rate should be higher than last year</u> because this investment phenomenon.

Recommendation No. 4: A higher capitalization rate is supported by market data for both market rate multifamily properties in Nebraska, as well as market data for rent-restricted properties in Nebraska and the Midwest. Based on meeting minutes, it also appears that sales data of affordable housing and market rate housing is also a consideration of the Committee in confirming that the calculated OAR is consistent with market data. In preparing this correspondence, CohnReznick extracted all available multi-family property housing sales transactions for the State of Nebraska which identified a capitalization rate. Since 2014, CoStar reported 162 data points for study. Our sales data of all multi-family property in Nebraska since 2014 indicated an average cap rate of 8.52% (Source: CoStar). An appropriate OAR for affordable property should at minimum be consistent with this rate, and should probably be higher, given differences in market rate vs. restricted rent properties.

Recommendation No. 5: It is our understanding that the Committee has been provided information in the past indicating that the appropriate capitalization rates for affordable property in the Cities of Omaha and Lincoln should be higher than for the remainder of the State of Nebraska. Our research included extraction of all available multifamily sales (including market-rate transactions) which reported cap rates on CoStar. The average rate reported was 8.78% for Lincoln, 8.62% for Omaha, and 7.98% for the remainder of the State of Nebraska; this information supports this position.

Conclusion

Making necessary adjustments for appropriate pre-tax Equity Returns, and for the appropriate weighted Mortgage Constant appears to increase the calculation of the **Overall Capitalization rate up to 8.2%**. This rate appears to be relatively supported by research of multi-unit housing in the State of Nebraska, which indicated an **average of 8.59%** over the past four years, although an appropriate rate for affordable housing should probably be above the average of market rate facilities. We note that the State Housing Agency, Nebraska Investment Finance Authority (NIFA) had previously conducted a study which revealed a **capitalization rate of 8.6% industry wide in Section 42 properties**. Again, this appears to support the data and analysis indicated above.

As advisors, auditor’s and tax preparers for the affordable housing industry, we believe the identified range of capitalization rates is consistent with market standards and appropriate for affordable housing within the State of Nebraska, as it relates to the Committees’ direction to choose capitalization rates for the annual tax assessment process.

We sincerely appreciate this opportunity to be of service to you. If you have questions or concerns regarding this letter, please do not hesitate to contact me at (312) 508-5892.

Sincerely,

CohnReznick LLP

Digitally signed by Andrew R. Lines
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Andrew R. Lines, MAI, is a partner for CohnReznick Advisory Group's Valuation Advisory practice who is based in the Chicago office and has been a CohnReznick employee for over six years. Andrew has been involved in the real estate business for more than 16 years and has performed valuations on a wide variety of real property types including single- and multi-unit residential (including LIHTC), student housing, office, retail, industrial, mixed-use and special purpose properties including landfills, waste transfer stations, marinas, hospitals, universities, telecommunications facilities, data centers, self- storage facilities, racetracks, CCRCs, and railroad corridors. He is also experienced in the valuation of leasehold, leased fee, and partial interests, as well as purchase price allocations (GAAP, IFRS and IRC 1060) for financial reporting.

Valuations have been completed nationwide for a variety of assignments including mortgage financing, litigation, tax appeal, estate gifts, asset management, workouts, and restructuring, as well as valuation for financial reporting including purchase price allocations (ASC 805), impairment studies, and appraisals for investment company guidelines and REIS standards. Andrew has qualified as an expert witness, providing testimony for eminent domain cases in the states of IL and MD. Andrew has also performed appraisal review assignments for accounting purposes (audit support), asset management, litigation and as an evaluator for a large Midwest regional bank.

During Fall 2013, Andrew was accepted as a Fellow under the Plan for Economic Growth and Jobs (PEGJ) for World Business Chicago, the Mayor's Economic Development arm. Under Strategy 1: Advanced Manufacturing, Andrew participated in the development of a proposal for a $70 Million grant from the Department of Defense for a new Digital Manufacturing and Design Institute, which Chicago was awarded in February 2014. Under Strategy 9: Neighborhoods, Andrew helped administer a Urban Land Institute (ULI) advisory services panel for the Garfield Boulevard Corridor in Chicago's Washington Park, which made land use recommendations in leveraging the CTA's reinvestment on the South Side elevated trains. This process entailed working with two Alderman, as well engaging key community stakeholders for the panel to interview.

Andrew lends his expertise through frequent presentations including lectures on ASC 805 and Fair Value for Real Estate and CohnReznick's Commercial Real Estate practice annual audit training.

Andrew has earned the professional designation of Member of the Appraisal Institute (MAI). He has also qualified for certified general commercial real estate appraiser licenses in Arizona, California, Maryland, Florida, Wisconsin, Georgia, Illinois, Indiana, New Jersey and New York. Temporary licenses have been granted in Connecticut, Colorado, Ohio, Pennsylvania, Idaho, Kansas, Minnesota, Washington, Iowa and South Carolina.

Education

- Syracuse University: Bachelor of Fine Arts
- MAI Designation (Member of the Appraisal Institute)

Professional Affiliations

- Chicago Chapter of the Appraisal Institute
    - Alternate Regional Representative (2016 – Present)
    - MAI Candidate Advisor (2014 – Present)
- International Real Estate Management (IREM)
- National Council of Real Estate Investment Fiduciaries (NCREIF)

Community Involvement

- Syracuse University Regional Council – Active Member
- Syracuse University Alumni Association of Chicago, Past Board member
- Chicago Friends School – Board Member

Presentations/Panels

- "Valuations/Financial Reporting" IMN – CFO (west) Private Equity Conference; Carlsbad, CA – May 2015
- "Fair Value and ASC 805", Masters of Accounting Seminar, Georgetown University – October 2013
- "Fair Value and ASC 805", Internal CohnReznick Audit Training, Los Angeles, CA – November 2014
- "Fair Value and ASC 805", Internal CohnReznick Audit Training, Bethesda, MD – September 2014

Appraisal Institute Classes Completed

- 15-Hour National USPAP (2005); 7-Hour National USPAP (2009; 2011; 2013; 2014; 2016; 2018)
- Basic Appraisal Principles (2005)
- Basic Appraisal Procedures (2005)
- Basic Income Capitalization (2006)
- Eminent Domain and Condemnation (2006)
- General Applications (2007)
- Residential Sales Comparison and Income Approaches (2007)
- Advanced Income Capitalization (2008)
- Capital Market Conditions and its Impact on Real Estate (2008)
- General Appraisal Market Analysis and Highest and Best Use (2008)
- Associated Guidance Leadership Program (2008)
- Online Supervising Appraisal Trainees (2008)
- Report Writing and Valuation Analysis (2009)
- Advanced Sales Comparison & Cost Approaches (2009)
- Advanced Applications (2009)
- Business Practices & Ethics (2009)
- Appraisal Curriculum Overview (2-day general) (2011)
- Analyzing Distressed Real Estate (2011)
- General Demonstration Report – Capstone Program (2012)
- General Demonstration Report Writing (2012)
- Candidate for Designation Program (2013)
- Appraising the Appraisal: Appraisal Review – General (2013)
- Advanced Internet Search Strategies (2013)
- FHA and The Appraisal Process (2013)
- Legislative Session (2013)
- Candidate for Designation Program- Advisor (2013)
- 2014 Illinois Supervisor/Trainee Seminar (2014)
- Illinois Appraisers Seminar (2014)
- Data Verification Methods (2015)

- The Discounted Cash Flow Model: Concepts, Issues and Apps. (2015)
- Appraisal Convenience Stores (2016)
- Rates and Ratios: Making Sense of GIMs, OARs, and DCF (2016)
- Uniform Appraisal Standards for Federal Land Acquisitions: Practical Applications (2017)
- Review Case Studies – General (2017)

Clientele Served

- FDIC
- Amtrak, Metra
- Churchill Downs
- BMO Harris
- Commonwealth Edison/Exelon
- Water Reclamation District of Greater Chicago
- DePaul University
- Hartz Mountain, Inc.
- American Healthcare Investors, Inc.
- Ventas/Lillibridge
- Advocate Healthcare
- CBS Radio/Outfront Media
- Righeimer Martin & Cinquino
- Ross & Hardies
- Mayfair Development Group
- First Washington Realty
- DuPage County Forest Preserve
- NIPSCO
- Related Companies
- Preferred Apartment Communities
- Lowe Enterprises
- Carl M. Freeman Companies
- Cortland Partners
- Tierpoint
- 365 Data Centers
- PNC Bank
- The John Buck Company
- Foulger-Pratt
- Chevy Chase Land Company
- Quadrum Global
- Walton Development USA
- Skanska USA
- Magnetar Capital
- USAA
- Burroughs and Chapin
- GTIS Partners
- Toll Brothers
- The Pal Group (Palumbo)
- Urban Development Group
- Neal and Leroy
- The Village of LaGrange
- The Village of Lake Zurich
- The City of Des Plaines
- The City of Barrington
- The City of Chicago
- Pathway Senior Living
- The Gencom Group
- SL Industries
- Moduslink Global
- Empire Petroleum
- Other developers, attorneys, banks, individuals, et al.

Notable Assignments Completed

- Willis Tower
- McCormick Place Expansion Projects
- The Arlington Park Race Track Complex
- Carson Pirie Scott – State Street Chicago
- The Chicago Board of Options Exchange
- Hartz Mountain Portfolio (Hotels and Distribution Centers)
- DePaul University's Lincoln Park Campus
- Ritz-Carlton Hotels in Florida and California
- Morris Airport Expansion Project
- The Sedgebrook CCRC (Erickson)
- Drake Hotel, Chicago
- Estrella Mountain Ranch Master Planned Community

- Westphalia Master Planned Community
- 11 Madison Avenue
- Trump Tower (NYC) Penthouse Condominium
- Icon Tower – Las Olas
- Former Kraft Corporate Headquarters (Northbrook, IL)
- United Technologies Corporation Headquarters (Farmington, CT)
- ComEd/Exelon Corporate Headquarters (Oakbrook, IL)
- Rochelle Community Hospital
- Idaho Waste Systems Landfill
- DeWitt County - Clinton Landfill
- Rochelle Landfill
- Silver Spring Metro Center
- Rockville Metro Center
- Park Potomac Buildings D, E & G
- Mid-Town Athletic Club (Chicago)
- Wilmette Harbor Marina
- Racine County Marina
- Potomac Yards and Waterfront Station
- Port Covington – Sangamore Development Land

Valuation Impact Studies

- Landfills
- Big Box Retail Developments
- Electric Power Transmission Lines
- Solar Farms
- Environmental Stigma
- View Amenities