How Revising Your Financial Model Post-Closing Can Add Value to Your HTC Transaction

With market and economic conditions changing so rapidly, historic tax credit (HTC) developers, syndicators, investors and lenders are updating their financial models more frequently for their HTC projects. In this episode of Tax Credit Tuesday, Michael Novogradac, CPA, and guest Dave Graff, CPA, discuss specific development costs that they see changing most often in the current economic environment, as well as some of the unexpected situations that arise that can cause delays in tax credit delivery.

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Transcript

Introduction

[00:00:11] Michael Novogradac, CPA: Hello, I'm Michael Novogradac, and this is Tax Credit Tuesday. This is the June 20th, 2023, podcast. We have another exciting episode for you today. We're covering a topic that affects virtually any tax credit development: the importance of periodically updating financial models.

While updating financial models has always been important, current economic conditions make it much more crucial to increase the frequency of updating financial models. Now today we're going to talk specifically about budgeting and modeling for historic tax credit developments. But the discussion equally applies to new markets tax credits, low-income housing tax credits, renewable energy tax credits, and also opportunity zones.

Now we at Novogradac have been receiving a growing number of requests from historic tax credit developers, syndicators, investors and lenders to more frequently update financial models for their historic tax credit rehabilitation projects. Now, for some of our clients, we're providing quarterly updates because economic and market conditions are changing so rapidly.

In today's podcast, we're going to talk about some of the reasons why we're seeing this demand for more frequent updates to financial models. Various parties in the transaction request updated models for different reasons. For example, during the construction or rehabilitation phase, a construction lender may require an updated financial model before they fund a draw request.

In this situation, the construction lender, wants the updated model to revisit whether the developer, after updating their assumptions, has adequate sources to fund the projected uses during the development of the property. In essence, you know, you get through a few construction loan draws, and then the construction lender is saying, "Okay, there's been a number of changes in the market. We want to ensure the project has sufficient sources projected to fund the projected uses."

Now, unfortunately, more often than not, this exercise does reveal that a financing gap has arisen since the prior set of projections. Now, the good news is that by identifying the gap early, there are steps a developer can take to close the gap.

And my guest on the podcast today will discuss some of those steps. Now we also see developers updating their financial models when it appears the amount of tax credits that they're going to generate is materially changing. I should say, when the delivery of those credits is likely to be delayed or be accelerated, that does happen.

The updated models are then used by the developer to discuss these changes in tax credit amount and delivery with their syndicator and/or investor, and then potentially amend the partnership agreement and other documents such as the developer fee agreement, prime lease, and the like to adjust the agreements and the arrangements that they have with their investor.
Now, in addition to talking about why updated financial models are important, we’ll also discuss some of the specific development costs that we most often see change in the current economic environment, as well as some of the unexpected situations that can arise that can cause delays in tax credit delivery.

So you’re probably wondering who’s my guest today? Well, my guest today is my partner, Dave Graff. Dave is based in Novogradac’s Cleveland office. Dave is highly experienced helping developer clients review their budgets, initially prepare and update financial models, as well as conduct final cost certifications.

Dave has extensive experience helping clients navigate financing issues, so I’m super excited to have him share his insights with our listeners today. If you’re ready, let’s get started.

[00:03:59] **Michael Novogradac, CPA:** Dave, welcome to Tax Credit Tuesday. I think this is your inaugural podcast.

[00:04:06] **Dave Graff, CPA:** Thanks, Mike. Yeah, you are correct. This is the first timer for me, so I’m looking forward to having a fruitful discussion.

**Overview**

[00:04:11] **Michael Novogradac, CPA:** Well, thank you for making time to join us on the podcast today, and I look forward to having you back on future podcasts. Now in preparing for the podcast, you mentioned, that you’re seeing a growing number of developers requesting more frequent updates to their financial models. And specifically for their historic tax credit projects.

But I know that we’re also saying this low-income housing tax credits, new markets, renewable energy and opportunity zones and the like. You know, what do you see as some of the factors that are leading to this increased frequency in updating financial models?

[00:04:44] **Dave Graff, CPA:** Yeah, no, I think it’s a great question and I like how you kind of mentioned that this is not the only industry that’s kind of encountering this.

I know this is a routine exercise for renewable, updating ITCs. It’s, you know, different reason, but same goal. But going back to the historics, yeah, this is, definitely various reasons. The ones off the top of my head that I can say are primary would be, delaying construction timelines, rising cost for construction, inflationary reasons for maybe that’s impacting your NOI.

You need to, you know, maybe your NOI was already tight and now it’s even, maybe even tighter. Unplanned change orders. And, obviously interest rate volatility, which we all know is, pretty excessive at the moment. Unfortunately, you know, developers may be encountering one or more of these at the same time, and that’s, I think, even more of a reason why this exercise is especially critical to, to assess.

You know, a lot of these situations are beyond a sponsor’s control, and so for a sponsor, you know, updating what they can control is, step one, and then obviously planning for things they can’t control is
step two. And so it's critical that they keep going through this and, you know, just getting through closing is an accomplishment, but, that's not the end goal, right?

[00:06:00] **Dave Graff, CPA:** The end goal is to have this property and at the end, have a successful project. So, in doing that, it's a constant monitoring, constant nurturing of this project. And the financial model can be a tool to assist in that endeavor.

[00:06:14] **Michael Novogradac, CPA:** Yep. So thank you for that, Dave. And mentioning that reminds me a number of months ago I wrote a Washington Wire on all the dynamic changes that inflation's causing for tax credit properties.

And I talked about the impact of inflation and the rest on the uses, and that's kind of pretty, sort of direct. And then also the impact inflation can have on a variety of the sources. When I think about the overall kind of budgeting of sources and uses, and then I also wrote about the impact of inflation on income levels, on the income of the property, going to general over time along with the operating expenses.

As you know, it all becomes sort of circular because you have the uses, the sources, then you end up having the gross income it's going to generate over time operating expenses, which generates a net operating income. And then depending upon the change in that operating income, that goes back and affects the sources.

And it's all sort of a bit iterative. But I'll post a link to that article in today's show notes for our listeners. And it provides a bit of a paradigm to think about a financial model in the various sub-pieces of the financial model that Dave and I'll be touching upon today. But I think the article does a good job of breaking them out into sections.

So Dave, I did want you to share with our listeners, you know, what some of the major benefits for developers, lenders, and the others of these more frequent updates to financial models.

[00:07:41] **Dave Graff, CPA:** Sure. Yeah. And I think, I'll start off with developers here because I think obviously they're the catalyst of this whole thing.

They're the ones that are kind of going through this in the trenches. And so, you know, that time period from closing until placed in service and beyond, you know, there's a lot of uncertainty in that time period, especially with the things we've discussed as in the environment. the most important item is just identifying potential sourcing gaps.

Especially if you have variable rate debt. I mean, I've seen some pretty sizable interest rates at this point, and it's having a major impact on cashflow. So there's budgetary concerns, but there's also cashflow concerns. And I think a lender, an investor, a syndicator, they're all going to have different concerns.

And how do we formulate a solution for one or all of those problems? So with identifying potential sourcing gaps, obviously there's contingencies that are kind of contemplated upfront, and usually it's a
percentage of your overall hard cost. But, you know, 12 months ago that might have been a different number and, now labor shortages are driving up labor pricing. It doesn't take much for one project to go over budget. And I think we can all attest to that projects going over budget is the expectation. But you have to be able to have a contingency plan if that ends up being the case. You know, the revised forecast can help pinpoint, you know, earlier in this process that, hey, know, we're going to have maybe a million-dollar shortfall. What are we going to use to rectify that situation? Are we going to potentially go and talk to the lenders we're already working with getting a new lender potentially involved? There's maybe a co-sponsor who is then maybe in it for more of the cash return.

So they may be looking at it from a different angle. I know you and I kind of briefly discussed value engineering, kind of preparing for the podcast a little bit. You know, finding areas of your project where you can reduce cost but still maximize value. Change orders, working through those that maybe are unforeseen, deferring additional developer fees. Also a potential avenue. Or reducing the fee in general. Because at the end of the day, you know, that could be viewed as well. You're paying yourself back, here's just a reduction of this cost. That way we don't have to front that capital up right on day one. So there's many different ways that a sponsor can view this, but ultimately it comes down to what's going to be the best solution and the lowest cost of capital to achieve that solution.

And the sooner you have that, you know, a year in advance or six months in advance and not three months, are you giving yourself kind of a timeline? We all know how long it takes to close a historic transaction. So, you know, that won't be any different if you try to introduce a new source, down the road.

Another factor is, you know, HTC installments obviously are tied to, you know, usually three or four installments. There's a closing, and then you may not see HTC capital until placed-in-service date. And so that tax equity, you're kind of banking on down the road is likely not going to be the solution you're looking for.

Bridge financing potentially, but at the end of the day, that's going to get paid back with the sources from tax credits. So there's going to be a tangible need for sourcing and you know, adjusters do come into play, especially if you are going over budget. And most, you know, if not all operating agreements will address this.

[00:11:02] Dave Graff, CPA: The question is well how much of an adjuster is there? I've seen anywhere from 10 to even 25%. Obviously, the higher you can go, the better for your development, but, that's not always the case. And so if you have the ability to plan ahead and you know you're going to run into some construction cost overruns, You can have that conversation sooner with your investor and say like, "Look, here's where we are. Here's the reasons why we're going over budget. You know, can we modify our arrangement? Or is there a way around we can come to an agreement that, you know, this additional cost will be resulting in additional equity?" And I think that coming back to the focus of our discussion here, that revised model will be the best piece of information to show that investor because it's the deal they saw when they closed it. Them being able to compare apples to apples will make that process much smoother.

And also having Novogradac involved working through that process is going to add a little bit of, vetting to that arrangement.
Michael Novogradac, CPA: I obviously agree with everything that you're saying and the one thing I always think about with the financial model, and we talked about a little bit this when we were preparing for the podcast, that there is definitely a tendency, even myself to think, "Okay. I know what the change, I know of a few changes that have happened since the last model. In my own mind, maybe I can project what the consequences of that change are." And then when you actually think, okay, now I'm going to spend the time to update the financial model, you're looking and say, well, I have this additional cost overrun, but I also had, you know, a certain amount of contingency. So maybe my contingency just isn't as much now, and then I go and I look on the tax credit side and say, well, now that I have these higher costs, you know, some portion of them fit in qualifying rehabilitation expenditures such that I'll get some more tax credits and as a consequence I should get more historic tax credit equity.

But then as you point out, I then have to make sure that the adjusters and all the rest, the investor is eligible for that is going to buy those additional or invest additional equity for those additional tax credits. And then while I'm doing that, I think, okay, I'll revisit my operating income and expenses.

And maybe it's an affordable housing transaction, I'll have state low-income housing tax credits involved potentially, and the new income limit numbers that come out. So now I can adjust my income projections based upon the new income numbers. And there's all these various variables. And when you toss them all in, a lot of times the results in terms of financial gaps and the rest aren't necessarily what your gut tells you.

So it's really an exercise that you know, is when you go through all those different steps, you can quantify more accurately, you know what the difference is, and as you point out, then you can start focusing on how to solve that. Get that gap issue. And as I, as we also discussed preparing for the podcast, sometimes it's a net positive and you actually have, you know, a little bit more sources than uses, so maybe you have less deferred developer fee and the rest, that's not usually the case. But it does, it is, sometimes the case and it might influence your view on change orders and things of that nature. There might be parts of the development that you know, you would like to change or enhance, but you end up looking at it on balance and you feel like you don't have the money.

So there's a lot of ways in which the model can affect your behavior and the judgment that you're making.

Dave Graff, CPA: Yeah, and I will add one thing. you know, when you're kind of going through that and identifying that there is a source gap there, you know, it's highly likely that your lender is going to require you to kind of front that source before they put additional funds in, right? And so, knowing that in advance and kind of maybe projecting out, okay, well what do we need to put in now so that six months from now we're in a much better shape? They may say, hey, we need that equity in now. And so running through these exercises will help quantify that.

Michael Novogradac, CPA: I do know we've seen some where you know that you end up bringing in an additional equity investor that's just there for the cash flow. There's a number of ways in which developers can respond to these situations, but obviously you can't respond to what you don't know.

Dave Graff, CPA: Right.
Michael Novogradac, CPA: I liked your point about, you know, there might need to be more equity, et cetera. It might be one of those things where if you wait six months and then it gets revealed and then you're going to have delays in construction loan draw requests or delays in your equity contributions of the rest, and then you're in a sort, a cash bind without much time to address it.

So it's always as we say in the accounting business, you're always better off identifying any issues earlier than later because earlier in the process you identify it, the more options you have to solve it. So I know as part of updating the financial models for your developer clients, I know that you often also provide a more detailed review of their construction budgets.

Common Budget Errors and Misconceptions

And I was wondering if you could share, not, I was wondering, I'm asking you to, could you share some common errors or misconceptions that you find when you're doing a more detailed review of a developer's construction budget?

Dave Graff, CPA: Sure. Yeah, I think, obviously it's a discussion to have upfront.

It's great to kind of walk through those assumptions. You know, every developer may have their own education or understanding of what a QRE is and how it may impact their transaction. But as far as kind of common errors, misconceptions, you know, a lot of times we see maybe too broad of categories of line items, you know, whether it's a construction contract itself. It may just say hard cost and it's, okay, well what are those components of hard cost? What might be included in that? Is there exterior site work that's included? You know, I think broad categories. Obviously accountants love detail. We routinely will go through those, you know, even if it's a 30-page line item, I mean, at least you have it itemized and you have your best-case estimate of, you know, where you think you're going to fall.

And if that modifies or gets changed, you know, you can quickly identify which line items those were and say, look, you know, this was an eligible item. We think it's still fine. It's not something new that's being introduced or being uncovered later down the road that came as a surprise. One of the things that I would stress too, is understanding, like, let's say you have a rooftop, an addition or an enlargement items like those, you know, being able to quantify that they might be in the hard cost line item as a, in total, but understanding the project.

And that's kind of our job too, is to understand the development itself and what's expected to be rehabilitated. Understanding that relationship and where the plan is heading. On the architecture side, is there any new enlargements? Those are all factors we want to get an understanding of and how it may be applicable to the budget that you, the developers provided.

Some other areas of concern that we've seen are, you know, following the term sheet, like debt term sheets, and reserve requirements are a big item. Obviously those can be very substantial, especially in an interest rate environment that we're in now. They can be three to six months of opex.
And when you calculate what that might be for, let's say a hotel that can be pretty substantial and a very large nut to crack on day one, because a lot of times that's required at closing. So working through those term sheets and then identifying all the cost to that capital. And accounting for that in the forecast is critical, especially knowing the draw terms. You know, is it funded upfront or is funded net? Those are big, it could be big swings in how much interest you incur on a project if it's funded upfront, entirely at closing. Your incurring interest on those, all those dollars. And then as far as kind of the construction timeline, just understanding when equity is supposed to come in, you know, what's the benchmark?

Obviously closing, you know, that's pretty easy to follow. But, you know, understanding the C of O [certificate of occupancy] requirements for the second installment or third installment, you know, you could have other deliverables such as an audit or tax return required. Most certainly you're going to find that a cost certification's required, those are deliverables that, you know, obviously have their own lead time.

And so understanding that, you know, just because you placed it in service in, let's say November, doesn't necessarily mean you're going to get your HTC installment on December 1st. so planning ahead for those lead times is crucial.

[00:19:22] **Michael Novogradac, CPA:** And I would just note it that I did do a podcast, many, moons ago with, our partner Tom Boccia, and it was dealing with term sheets for historic tax rate transactions, we discuss a lot of those sorts of issues of not having the initial term sheet, having agreement, what the conditions were and the rest. So you're mindful of just what you said, if you're, if one of the conditions was placed in service, but also a tax return showing the credits, you know, that can have a notable impact on when you actually get the cash for the, equity contribution.

So being mindful of those during the term sheet phase. And I'll include a link that in addition as to that, but, being mindful of it, the time you're doing the term sheet, but then obviously then when you're, updating your projection, and the rest, keep all of that in mind. So, yeah.

No, please go ahead.

[00:20:10] **Dave Graff, CPA:** I was just going to, also add, you know, when we talk about potential delays in credit delivery, right? And let's say the, that placement service date slips from Q4 to Q1. That could even have a larger impact because maybe a deliverable is an audit or a tax return, and now you've got to wait potentially another full year to see that equity.

So, keeping that placed in service date in mind is always a critical concern for developers.

[00:20:35] **Michael Novogradac, CPA:** So a lot of what you talked about, on this response to the last question had to do with the, you getting kind of more detail, more information about what's in the price budgeted line items and the rest, so that forecast itself can more accurately estimate qualified rehabilitation expenditures or QREs so you more accurately generate the amount, estimate the amount of historic tax credit can be generated, as well as from a timeline perspective, understanding when different installments going to come into the rest. And obviously you got to make sure you got enough cashflow during the development process, during the construction phase, and then ultimately, you know, when you can start getting paid some of your developer fee.
So, but beyond looking at those, like the categorization, the timeline and the rest, I was wondering on the actual cost side, what types of costs are you seeing coming in over budget? You know that when you look at maybe the initial set of projections, there's a certain estimate for certain costs, but you're finding now that those particular categories are a lot higher than original estimates?

[00:21:40] **Dave Graff, CPA:** Yeah. I think the, the number one answer there is for sure is hard costs. You know, your construction contract. That's going to be the one that can probably fluctuate the most just because it's the majority of your budget, you know, and a 10% swing in that budget alone can have a pretty substantial effect on sourcing.

And then obviously later on, the calculation of HTC equity, like we said, we talked about already with adjusters. It kind of has a domino effect and yes, you know, knowing that upfront is sometimes out of your control and no one has a crystal ball. But, reacting to it and planning as well in advance as you can is going to be, critical.

But aside from hard costs, I mean it's, you know, reserves are usually kind of upfront and set aside, and those are more, I guess, known. But the longer that construction phase plans out, there may be requirements to say that, look, at no point our reserve can drop below six months and, you know, we've extended the construction timeline by six to 12 months potentially, you know, at that point, even though that reserve might not be the item that's over budget, you had to put in equity to keep it where it was.

[00:22:58] **Michael Novogradac, CPA:** Right.

[00:22:58] **Dave Graff, CPA:** You know, they may not let you deplete it entirely. And so those are key things too to keep in mind is. those reserve dollars may not always just be exactly, we get the money back.

If there's anything left over there may be some strings attached or some requirements of the developer to, to refund those initial dollars.

[00:23:20] **Michael Novogradac, CPA:** So you mentioned, earlier when we were talking about getting more detail on costs and the like, so that if there's, you know, enlargement costs that aren't eligible expenditures for historic tax credits, enlargement costs that you identify them. You don't identify them in the cost certification phase.

You don't identify them sort of upfront. And you mentioned furniture and fixtures, which also aren't tax credit-eligible, historic tax credit-eligible, because of course, historic tax credits are about, you know, preserving the historic integrity of the building or bringing it back, not buying furniture and fixtures.

So those costs aren't eligible. Rather than talk just about the costs that aren't eligible, what types of qualified rehabilitation expenditures, what types of costs aren't eligible to calculate your 20% tax credit that you find developers will overlook?

[00:24:09] **Dave Graff, CPA:** Yeah, I think that's a good question because, you know, soft costs are, you know, although they may not be the majority of the budget, they add up quickly.
And when you think about all the attorneys involved and the closing costs, property taxes and insurance carrying costs you have on the property throughout the construction period, those all need analyzed. And, the good thing is that the majority of them can be capitalized during that time.

Soft costs that pertain to professional fees need a little bit more of a lens applied to them. And oftentimes we reach out to tax attorneys and the counsel to kind of get their viewpoint on, hey, where did you spend the majority of your services? And we kind of get some of their feedback and we have a pretty good track record of just working with them.

[00:24:52] **Dave Graff, CPA:** And can you generally guide developers and sponsors in the way that we think, like, hey, we assume this was maybe going to be about a 20% it's just as an estimate, whereas maybe they were at zero or maybe on the other side of it as a hundred. So it's kind of just seeing what that initial budget is and making sure that even those costs are even accounted for.

Right? And understanding how much closing costs can be, those can be hard to predict, but, I think that's step one is identifying the cost itself. And then step two is what's the tax, implication of that cost. So I would say soft costs or critical developer fees. Sure. Some other items that can be potentially overlooked. Most developers are going to be a little aggressive on the developer fee side, but working through that, and obviously our constituents over and the colleagues over in the GoVal group at Novogradac has kind of understanding how to maximize that developer fee to the extent it makes economic sense, and that it is deemed reasonable.

Obviously, that's the critical item there that sponsors need to be aware of. But developer fees have some room. Obviously, if your construction budget is increasing, there may be some room to kind of, you know, commensurately increase that developer fee because you're obviously, they're putting more effort in, you're having to manage more items that are going on during the construction phase.

There's potential there that you can increase the fee that, the developer's earning.

[00:26:16] **Michael Novogradac, CPA:** Thank you, Dave. So it's clearly important to have an experienced historic tax credit consultant like yourself involved as early in the development process as possible. And I know when I was talking to Tom Boccia, I was like, well, when should the historic tax credit you know, accountant be involved? And it's like from the very beginning, even if you can, before you create your first proforma internally, but with your experience and expertise, I know that you help clients ensure that they have a more comprehensive financial model, as that starting point.

Also, I would just note as we're discussing, there are many variables that do change over that 12- to 24-month construction lease up period, which is why we've been talking about frequently updating models. So as we think about the initial comprehensive model, the updates during the course of the development and construction lease up phase, I thought maybe you could share with listeners beyond hard costs rising because of inflation, what other areas when you think about the financial model are some of the, generating some of the greatest changes? And I know there's a lot in all the rest, maybe just a handful. And maybe to frame it a little bit better, you know, we have the, you know, the initial estimates of construction costs and other development costs.
And we know that hard costs can be rising because of, or are rising because of inflation. As a general matter. Then there are sources, the various projected sources, tax credit equity, permanent loan financing, interim construction, loan financing, deferred developer fees, other, you know, gap financing. It could be equity for state credits, it could be other sources.

And then from a permanent lending sort our perspective indirectly we've got the operating income and the operating expenses that generate the NOI that'll ultimately be there to, that will size what the ultimate permanent loan is.

**Areas Commonly Experiencing Cost Changes**

When you think about all those various categories, maybe just highlight beyond, you know, increases in hard costs where when you're updating the forecast, you're seeing the greatest changes.

[00:28:25] **Dave Graff, CPA:** Yeah, I think it's as far as the greatest changes, I think timing is one of the, it's kind of like a twofold issue, right? Timing dictates when you're incurring the cost and when you're going to finish. And so when those hard costs increase, you need sources upfront to cover those increases.

Some of the other areas that we're kind of seeing the greatest shift would be NOI. And obviously that directly impacts your available cashflow. You know, with interest rates kind of increasing, there's going to be some more, restrictive debt service potential requirements.

I know DSCR, I think are, you know, they're starting to creep where they, you need a higher threshold, especially for transactions that there's way more volatility in the operations such as hotels, the hospitality industry. So I think in that context, available cash is key right now because other than once you solved the source problem, just because you maybe went over budget and you received additional equity, that additional equity doesn't always translate into a change in your cashflow assumptions.

And so that change in cashflow assumptions is directly impacted by external forces such as an interest. And that's the elephant in the room in the current environment.

[00:29:46] **Michael Novogradac, CPA:** Thank you for that. Because I definitely seen a number of developments as a view where from net operating income perspective, there's a, I should say from a permanent financing or takeout financing perspective, there's like a double whammy and that net operating income isn't as strong as initially projected. Certainly because operating projected, operating expenses are rising and operating income might not be rising, quite as much, so there's less net operating income. As if that isn't bad enough, you then have, if you don't have a permanent loan fixed rate takeout already in place, then you're, and that interest rate's rising and the net process you can generate. And even then, it's not just the interest rate that's going up that's causing you to not able to borrow as much on a lower NOI.

It's also, as you're mentioning, the debt service coverage ratios rising because of concerns about a coming recession. So they're just, so maybe I shouldn't say a double whammy, I should say a triple whammy. The combination of lower NOI, higher interest rates, and more conservative debt service coverage ratios.
And I'm sure our listeners are going well, really, it's a quadruple or quintuple or as they identify other issues and that amount of, matters that ultimately affect the amount of, permanent financing. So we've discussed the importance of more frequently updating financial models. We've talked about some of the common errors developers should be mindful of in putting together their initial performance.

[00:31:08] **Michael Novogradac, CPA:** We've also discussed the benefits of more frequently updating financial models to identify issues or opportunities sooner in the process, you can address them and have more runway to address those issues. I thought I'd maybe open it up now more broadly and ask what are the related tips or recommended practices you have for historic tax credit developers?

[00:31:30] **Dave Graff, CPA:** And I think there's, obviously this is not the all-inclusive list here, but I think these are, some that I think I’ve found very helpful and kind of set the table for going forward. And not just in the transaction at hand, but you know, future transactions that, you know, maybe a developer just kind of starting off, they’re done one or two deals and they’re looking for a way to kind of just maintain efficiency as they have more deals to monitor as well as create new deals. So I think one of those things which we’ve touched on today is just extensively discussing and assessing your budget.

Obviously, the more deals you go through, the better kind of sense you'll get of where we should fall on that initial run of your proforma. You know, and also doing that as early as possible and talking to someone as early as possible too because if you come in with a, an estimated capital stack, that has some inconsistencies in the assessment of QRE, you may have another problem that you didn’t think you had before you talked to the professional. So, I think this will at least assist in giving you a best estimate.

Now, granted, it's an estimate, but, you know, at least you’re kind of contemplating the, you know, the impacts on HTC equity and when you have a federal and state HTC transaction this impact is even more compounded because now you have, you know, for every 10% error you have on the federal QRE, you have a 10% error on your state QRE and most likely that situation, so double the impact on one assumption. And, you know, that’s a lot of dollars that could be left on the table potentially.

So early and often discussions on the budget. And then also, you know, trying to get as soon as applicable, a construction timeline that, you know, can be relied on because I think that’s going to set the tone for interest costs. It’s going to set the tone for how much you know and how often you’re going to need to potentially put equity in the deal.

Like I said in the beginning, you know, developers are going to be usually required to kind of upfront their capital at closing. But understanding the place-in-service timeline has a really big impact on that assumption. You know, if you are already getting a construction timeline from a contractor that says, you know, December 1st, you know, that’s one to keep an eye on because obviously that can either move forward, which is unlikely.

But I’ll also, you know, go beyond that year end. And, you know, as long as your investor understands that’s a possibility and they’re kind of building that into the pricing, you know, that’s something just to keep your mind on.
Additionally itemizing costs. I know we kind of talked about that itemizing the budget as much as possible. Trying to isolate the big ticket items that, you know, maybe someone may have questions on, like such as enlargements or, hey, we did this big rehab of the sidewalk outside. You know, somebody would need to make sure that you’re excluding that from the overall QRE assessment. And then I think pre-closing, you know, establishing a record-keeping system that you know is going to work for not just the developer, but you know, as they continue through the draw process, the lenders are going to want to take a look at all the records that are kind of in, within that draw.

And I found that, Smartsheet, which is a pretty inexpensive tool, helps in kind of making that process more efficient. Lenders can have access to it, the sponsor can have access to it, Novogradac can access to it. And it kind of helps keep track of where things are and, you know, without having to kind of dump all the accounting records and have someone access to your internal records, those are processes that I think are just going to be extremely beneficial.

And as you progress towards the cost certification phase, which you know, there's no, wrong answer to when you should start that process, earlier, the better. That way you can work through any hurdles that you may have. you know, and that way you can benefit from HTC equity when you really intended it to come in.

Right? so I think those are just some high-level items, but I found that the record keeping system makes the whole process, immensely efficient and allows the equity to go as modeled.

Exit

[00:35:38] Michael Novogradac, CPA: Great. Thank you, Dave. and I will share your contact information today's podcast show notes so listeners can contact you directly with any questions.

They can also reach out to either one of us by sending an email to cpas@novoco.com. Please do stick around to the end of our episode for our Off-Mike section. I'll get to ask you for some fun recommendations and words of wisdom.

To our listeners, please be sure to tune in next week for my partner, Tabitha Jones. I guess I should say our partner, Tabitha Jones, will be joining me for another episode in our "So You Want to be a LIHTC Developer?" Series. Tabitha will be here to talk about placed-in-service packages for low-income housing tax credit properties. We'll discuss how the placed-in-service package differs from the initial application package.

We'll discuss what's involved in the placed-in-service package and discuss some of the differences for those packages for 9% allocated low-income housing tax credit versus 4% bond-finance transactions. And there'll be other topics we discuss as well, including areas that we find can often trip up developers when they're submitting those placed-in-service packages.

If you're an affordable housing developer, owner, or considering some other role, you want to be sure that you tune in. And if you have any questions you think we should cover in that episode, please email me at cpas@novoco.com.
[00:37:06] **Michael Novogradac, CPA:** So now I’m pleased to reach our Off-Mike section. So Dave, one of my common questions, sort of a theme in my Off-Mike section is work-life balance.

And it’s definitely something that I continue to work at. I won’t say struggle with because it’s something that I am very mindful of, but I always want to do a little bit better. So, if I had ask you to share one of your favorite work-life balance tips.

[00:37:33] **Dave Graff, CPA:** Yeah, it’s a good question. And sometimes you have to kind of think about it. You’re like, well, what do I do? Because you kind of just, you get in that, that routine, right? And you’re just like, well, what do I do? That kind of sets that apart. And when I kind of think about this question, I’m like, well, you know, kind of growing up, it was do what was fun. Like for me it was sports and playing baseball and studying those kinds of things.

So this year I made sure I joined a softball league. Now the hard part is staying healthy and not getting injured. But that’s also one of the great things is just getting involved in something that, you know, allows you to kind of separate the day-to-day-from, you know, something you’ve done in your past that made you happy.

[00:38:15] **Michael Novogradac, CPA:** Well, great. I like that. It’s been a while since I’ve been in a softball league. I’ll have to give that some consideration, but I’d love to go off on a tangent talking about baseball. My son played baseball. My daughter plays softball, but I won’t do that. We’re definitely a stick and ball family.

But my second question is, what’s one of the best leadership lessons you’ve learned?

[00:38:38] **Dave Graff, CPA:** Yeah, I think that’s, obviously there’s many great answers to this. For me, I think, leading by example has been one of the biggest ones that’s always kind of called to me, you know, going back to kind of our sports, discussion here, you know, kind of being a leader on a team, you know, kind of transitioning that mindset to, you know, professional life, right?

You have a team kind of leading by example, showing them the way. You know, I think that’s one of the things that was instilled in me, my dad, you know, big team leadership proponent and, You know, I think that sets the tone for everybody, right? And, kind of showing the path is what I think is the right way to, to do it.

And doing it the right way, too. It’s not just getting it done. There’s a right way and a wrong way.

[00:39:22] **Michael Novogradac, CPA:** Yeah. I appreciate that very much. I myself, when I, when you say that, I just think you shouldn’t expect of others what you don’t expect of yourself, right? And leading by example is all of that mindset. So I appreciate that, very much and a big believer in that. So I
appreciate you sharing that. Let me just say thank you again, Dave, and great job on your inaugural Tax Credit Tuesday appearance.

[00:39:45] **Dave Graff, CPA:** Thank you. Look forward to many more.

[00:39:47] **Michael Novogradac, CPA:** Hopefully it is the first of many. And to our listeners, I’m Mike Novogradac. Thanks for listening.
Additional Resources

Email

Dave Graff

Novogradac Journal of Tax Credits

Effects of High Inflation on Development, Financing and Operation of Tax Credit-Financed Housing
(March 2022, Novogradac Journal of Tax Credits)

Tax Credit Tuesday

July 19, 2022: How to Compare HTC Term Sheets Beyond Price Per Credit