Crucial Underwriting Considerations for LIHTC Investors in the Wake of Bank Failures

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The recent failures of Silicon Valley Bank and Signature Bank (the "Bank Failures") created much uncertainty in a variety of industries across the United States, and the affordable housing industry is no exception. Consequently, now may be the time for low-income housing tax credit ("LIHTC") investors to revisit their underwriting criteria for their equity guarantors ("LIHTC Guarantors"). Among a multitude of other things, there are two crucial areas that LIHTC investors should consider in the wake of the crash:

- The source of guarantor liquidity; and
- The amount of guarantor liquidity

Source of Guarantor Liquidity

A typical LIHTC partnership agreement (a "Partnership Agreement") will impose several financial obligations on LIHTC Guarantors related to a project's operations, such as funding development deficits, funding operating deficits, and covering certain indemnification obligations. Consequently, such Partnership Agreements will usually impose ongoing financial covenants for LIHTC Guarantors, pursuant to which they must maintain certain net worth and liquidity thresholds. LIHTC investors should carefully evaluate the source of a LIHTC Guarantor's liquidity to determine whether it's based on traditional liquid assets (*i.e.*, cash, cash equivalents, or securities) or derived from a letter of credit from a bank. If a letter of credit accounts for a material piece of a LIHTC Guarantor's liquidity, then careful consideration should be given to the bank from which such letter of credit was issued and whether another bank should be required in the wake of the Bank Failures.

Amount of Guarantor Liquidity

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The swiftness of the Bank Failures left many questioning the stability of other financial institutions and the security of their existing credit facilities. Specifically, there may be uncertainty surrounding whether a construction lender may deny draw requests during the construction period and whether a LIHTC investor would be potentially required to make any equity installments prior to project completion. Consequently, in addition to the source of a LIHTC Guarantor's liquidity, LIHTC investors may want to consider the amount of such liquidity and whether the LIHTC Guarantor has sufficient wherewithal to (1) substantially complete the project to get to the completion equity installment, or (2) carry the project until replacement debt can be sourced. Additionally, if the project is a 9% deal, then special attention should be provided to whether the LIHTC Guarantor's liquidity is sufficient to cause the project to satisfy the 10% test and the mandatory placed in service deadlines under the Internal Revenue Code.

Conclusion

In uncertain times, the strength of a deal's guarantor becomes paramount, and LIHTC investors should carefully consider the source and amount of a guarantor's liquidity. Specifically, LIHTC investors should consider the source of a guarantor's liquidity (*e.g.*, whether it's derived from letters of credit) and the amount of liquidity (*i.e.*, is there sufficient liquidity to carry a project through completion or at least float it until replacement financing is received while ensuring that all milestone dates under the Internal Revenue Code are satisfied.)

Frost Brown Todd counsels investors, developers, lenders, and other key stakeholders on low-income housing projects across the country. We stay at the forefront of all critical issues affecting the affordable housing industry, and we are ready to assist clients with navigating the rapidly changing environment. For more information, please contact Maci Followell, Brad Butler, or any attorney on Frost Brown Todd's Multifamily Housing industry team or Failed-Bank Response Team.

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