Bedford Lending

Real Estate Tax Abatements & TIFs in HUD Loans

HUD will recognize various tax "savings" or "abatements" in underwriting as a way to improve overall loan proceeds and reduce borrower equity at closing.

Please note:

- Tax abatements that run with ownership rather than the real estate / land can be problematic. The risk that a transferee of the project or an assignee of the mortgage in the future might cause the tax abatement to be lost is an unacceptable risk to HUD.
- Tax abatements that are based on a state law that can change over time can be problematic.
- Tax abatements tied to certain performance metrics can be problematic.
- HUD will expect to see a borrower's attorney provide an opinion letter during underwriting which memorializes how the proposed tax abatement / TIF will satisfy HUD's programmatic requirements detailed in the "MAP Guide".

The following are four common scenarios:

Long Term Abatement – When a tax abatement is coterminous (35-40 years) with the proposed HUD loan, the loan can be underwritten with the abated real estate tax expense, which can dramatically improve overall loan proceeds due to a higher NOI. Similarly, coterminous abatements can be used to increase appraised value in refinance or acquisition scenarios under the 223(f) program.

The HUD 221(d)(4) program is cost-based, and thus the only impact of a tax abatement increasing value is realized through a potential increase in land value or as-is structure/shell value for rehab projects. As-complete project value is not used under the 221(d)(4) program.

Short Term Abatement – Any abatement with a term shorter than the proposed HUD loan term is a "short term" abatement. We must underwrite with unabated taxes as an operating expense, but then will credit the tax savings over the abatement term as additional revenue to increase total proceeds. Short term abatements cannot be used to increase project value in any capacity under any HUD program.

The following is an example of how a short term abatement can help:

A. A 40 year HUD 221(d)(4) new construction loan is underwritten with unabated taxes in operating expenses. The unabated taxes are $930,000 per year.
B. The resulting NOI with unabated taxes is $4,807,000.
C. At a 40 year term, 1.11x debt coverage ratio, 5.99% interest rate, and 0.25% mortgage insurance premium rate, this $4,807,000 NOI qualifies for a loan based upon debt service coverage of ~$63,286,000.
D. The project will be securing a 20 year tax abatement with average annual tax savings of $700,000 per year.
E. This 20 year abatement, at the same interest rate and mortgage insurance premium as the underlying 40 year mortgage, would qualify for additional mortgage proceeds of $7.91mm:

	Abatement		Rate	MIP	Amort	DS Consta	Add'l Mortgage Proceeds	
1	$	700,000	5.99%	0.25%	97.28%	103.52%	$	676,170.40
2	$	700,000	5.99%	0.25%	47.19%	53.43%	$	1,310,141.94
3	$	700,000	5.99%	0.25%	30.51%	36.75%	$	1,904,715.88
4	$	700,000	5.99%	0.25%	22.19%	28.43%	$	2,462,488.09
5	$	700,000	5.99%	0.25%	17.20%	23.44%	$	2,985,866.31
6	$	700,000	5.99%	0.25%	13.89%	20.13%	$	3,477,085.76
7	$	700,000	5.99%	0.25%	11.53%	17.77%	$	3,938,223.19
8	$	700,000	5.99%	0.25%	9.77%	16.01%	$	4,371,209.64
9	$	700,000	5.99%	0.25%	8.41%	14.65%	$	4,777,841.95
10	$	700,000	5.99%	0.25%	7.33%	13.57%	$	5,159,793.31
11	$	700,000	5.99%	0.25%	6.44%	12.68%	$	5,518,622.70
12	$	700,000	5.99%	0.25%	5.71%	11.95%	$	5,855,783.68
13	$	700,000	5.99%	0.25%	5.10%	11.34%	$	6,172,632.25
14	$	700,000	5.99%	0.25%	4.58%	10.82%	$	6,470,434.11
15	$	700,000	5.99%	0.25%	4.13%	10.37%	$	6,750,371.30
16	$	700,000	5.99%	0.25%	3.74%	9.98%	$	7,013,548.28
17	$	700,000	5.99%	0.25%	3.40%	9.64%	$	7,260,997.47
18	$	700,000	5.99%	0.25%	3.10%	9.34%	$	7,493,684.40
19	$	700,000	5.99%	0.25%	2.84%	9.08%	$	7,712,512.41
20	$	700,000	5.99%	0.25%	2.60%	8.84%	$	7,918,326.96

F. The mortgage that can be increased with tax savings is underwritten with a 1:1 debt coverage ratio.
G. The combined mortgage amount is now ~$71,200,000 ($63,286,000 + $7,918,000). The additional $7.91mm mortgage supported by the short term tax abatement will hyper amortize under its own 20 year amortization schedule.

Payment-in-Lieu-of-Taxes (PILOT) – A payment in lieu of taxes is a tax expense that is inherently lower than ad valorem taxes. This is often seen with Housing Authorities and other quasi-public institutions. For example, a Housing Authority is exempt from paying real estate tax under state law, however a "Cooperation Agreement" between the Housing Authority and a respective municipality memorializes a payment due annually based upon tenant collections. This "voluntary" payment helps cover the overhead of emergency services or other services that project residents benefit from.

Often shorter term but may be long-term. The savings over the PILOT period are treated with the same logic as a long or short-term abatement, as applicable.

Tax Increment Financing (TIF) – Municipalities can provide a "reimbursement" or credit of real estate taxes to developers under the assumption that a development will increase the assessed values of surrounding areas. Ideally, the "reimbursement" to the developer of a project is at least revenue neutral to the municipality. The benefit of a TIF is realized in two ways with HUD:

A. Equity - in this scenario, someone is purchasing the future anticipated TIF reimbursement, typically at a discount under a net present value calculation. For example, $5,000,000 in TIF monies is anticipated over a 20 year period. An investor may "purchase" this revenue stream and provide a lump sum of $3.5mm to ownership. In this scenario, no additional mortgage proceeds are factored in, as the TIF benefits are inherently realized in additional equity.
B. Mortgage Proceeds - the additional TIF revenue is treated the same as a long term or short-term tax abatement to increase overall mortgage proceeds based upon cumulative debt service coverage, as applicable.

Please note, occasionally a tax abatement or TIF is not able to be fully realized; for example, as HUD will [not allow short-term](#) tax abatements to be recognized in concluded, appraised project [value](#), a scenario could occur where on paper the cumulative mortgage amount based upon debt coverage is higher than the mortgage based upon loan to value (in a refinance/acquisition scenario), and we would default to the lower of the two.