

Commercial Mortgage Insight

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Affordable Assisted Living: Creative Ways To Make It

This second article of a two-part series explains how Medicaid and tax credits help solve some of the challenges of housing the elderly.

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In the first article in this series, we discussed how affordable multi-family units could help solve the problems raised by housing the elderly who are relatively healthy and need some assistance, but are by no means in need of nursing home care. Our discussion of programs available to take advantage of the low-income housing tax credit (LIHTC) program continues.



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The Medicaid provisions of the 41 states that provide assistance for assisted living generally do not require “continual or frequent nursing, medical or psychiatric services.” Medicaid can, therefore, be received in a facility that is constructed with the equity generated through the LIHTC program. The amounts of Medicaid reimbursement should generally not be considered part of “gross rent” under an exclusion, as described in Internal Revenue Code Section 42(g)(2)(B)(iii).

Most tax attorneys that have reviewed the requirements have concluded that even services that are paid for by residents directly, not by Medicaid, can be considered “optional” if the resident has the option of using a

provider other than the owner/manager of the facility. If the services are made optional in this manner, the payment for services should not be considered part of the restricted rent. Consequently, the amount needed to pay for the services should not disqualify one from using LIHTCs because of the required rent limitations. Numerous affordable assisted living facilities are being developed, owned and operated under the LIHTC program, and most are assisted with Medicaid.

State LIHTC allocating agencies are beginning to recognize the great need of this significant segment of the population. Many states are giving priority under their “qualified allocation plans” – the process by which the states allocate LIHTCs among various competing projects in each state. This trend is a positive one and reflects the state agency’s desire to help satisfy the needs of its constituents.

Strings attached to qualify

The LIHTC program, like most other government subsidies, comes with strings attached. The facility must remain “low-income” for a period of 15 years to avoid “recapture” of credits. As long as sufficient Medicaid funding is available to take advantage of the LIHTCs, the facility should be able to stay low-income indefinitely.

To take advantage of LIHTCs, the

ownership of the facility must be in a partnership for federal income tax purposes, generally either a limited partnership or a limited liability company, for state law purposes. One or more investors who can use the credits must be admitted to the partnership, as owners. Generally this is a greater than 99% ownership interest. The developer can receive a host of free and significant profits and residential interests. But the developer must give up significant ownership rights, including certain economic rights, for at least 15 years.

The developer may receive a significant developer fee up front, typically between 10% to 15% of the total development costs. There are other fees, such as management, incentive management, sales, administrative, oversight and marketing, that may mitigate the loss of ownership for 15 years. But the ownership interest of the investor must be real. The credits are not wholly separate from the ownership of the facility.

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The investor in a LIHTC facility will generally also want certain rights – such as the ability to remove the general partner and manager under certain conditions. If things do not go as planned, the developer will not have a “silent partner.” In addition, there are also numerous compliance and regulation requirements that go along with the LIHTC. The residents must be income certified annually. There may be LIHTC inspections from the state agency and the investor. There will be more governmental and investor scrutiny with LIHTCs.

There are other programs that are available to facilities that are considered housing, as opposed to healthcare facilities. Since the assisted living facilities may qualify as “residential rental facilities,” many of the housing programs, in addition to the LIHTC program, could be accessed and used. Many states have an “Affordable Housing Trust Fund” funded out of transfer taxes that can provide subsidies, loans or grants. HOME Investment Partnership Program funds, the so-called “HOME program,” may be available through subsidized loans or grants. Even Section 8 may be available, providing either a tenant-based or project-based rental subsidy.

Many states and local municipalities have additional programs. The Federal Home Loan Bank, Affordable Housing Program, may have funds to bridge costs. The U.S. Department of Agriculture has loans and interest subsidies, as well as food stamps and rental subsidies. Each of these programs may provide some degree of subsidy. Each has various “strings” or requirements and oversight.

A significant program that does not require the facility to be a residential rental facility is the program of loan insurance under Section 232 of the National Housing Act (NHA). Section 232 provides mortgage insurance from the Federal Housing Administration (FHA) for nursing homes, intermediate care facilities, and board and care homes. Assisted living facilities generally qualify as “intermediate care facilities” if they receive Medicaid reimbursements. The state will license or regulate these facilities. The Section 232 program allows the facility to lease to residents who “require minimum but continuous care, but are not in need of continuous medical or nursing

services” (Section 232[b][2] of the NHA). These are the typical assisted living residents. The FHA insurance will enable the developer of a facility to obtain a non-recourse loan for up to 90% of the cost of construction or acquisition of the facility. The downside includes additional regulation by the U.S. Department of Housing and Urban Development (HUD), the requirement to pay “prevailing” or union wages under the Davis-Bacon Act, and the need to prepare architectural drawings early in the predevelopment stages of the deal.

Financial mix considered

The ideal financing strategy for a particular facility will depend on the market for assisted living in its location and the cost associated with developing the facility, including the cost of land. The mix of financial incentives generally will depend on what is necessary to make the facility financially feasible. Blair Minton & Associates of Bourbonnais, Ill., is a manager and developer of affordable assisted living in Illinois with 11 facilities under ownership, management or in development. Minton has certain priorities for what kinds of subsidies he chooses for his facilities, which are all under the SLF program. Company founder Blair Minton’s first choice is conventional financing, followed by FHA 232. His last choice is LIHTCs.

Minton prefers conventional financing where the market can bear it. In certain places in Illinois, conventional financing along with Medicaid may be able to provide sufficient funds for construction and operation of the facility, he says. In these locations, there is a very strong market of seniors needing the services, and costs, especially of land, are reasonably inexpensive. Conventional financing is generally recourse, but is the vehicle with the fewest hassles and entangling requirements. In Minton’s experience, the appropriate mix of Medicaid beds to market-rate beds is 50/50.

His second choice would be to issue FHA 232 loans without LIHTCs. The 232 loan has the advantage of being non-recourse, but requires at least 10% equity, prevailing wages and increased predevelopment costs. His last choice is the use of LIHTCs, because of the additional requirements and involvement of equity partners. But to make most deals feasible in most locations, LIHTCs are necessary. Most of his fa-

cilities are subsidized by LIHTCs, either through an allocation of LIHTCs or through the “automatic allocation” that comes from issuing tax-exempt housing revenue bonds. All of Pathway’s facilities combine LIHTCs with the Medicaid waivers.

Chicago Equity Fund Inc. (CEF) and Illinois Equity Fund Inc. (IEF) are leading LIHTC syndicators in Chicago that have been instrumental in making the SLF program work seamlessly with LIHTCs. William Higginson, president of CEF and IEF, states that both entities have been investing in affordable assisted living facilities to obtain LIHTCs for investors for the past five years. He indicates that the quality of the location and the operator are keys to success. He states that it is helpful for the developer involved with the facility to “be an experienced LIHTC developer.” But more often than not, experienced developers of LIHTC projects are not experienced in the operations of assisted living facilities.

Investors in LIHTC facilities

In addition to CEF, there are numerous LIHTC investors that are investing in assisted living facilities. Nevertheless, many syndicators are not willing to look at these investments, which are not yet the norm. In a market such as the market for LIHTC, in which the product has become rather standardized, investments that are not within the normal business of the syndicator are more difficult to monitor and manage. Some syndicators may not be willing to do anything outside normal rental business. In my view, this is a loss for those that are not willing to invest the time and money necessary to look at this species of LIHTC investment. It is also an opportunity for the syndicators and investors that are willing to invest the time to understand the business.

Affordable assisted living through Medicaid, LIHTC and other subsidies can become viable alternatives to nursing homes. In the long run, the facilities satisfy a significant need facing our aging population. At the same time, these facilities can save money for states under their Medicaid programs. Affordable assisted living through Medicaid, and where necessary, LIHTCs, is a “win-win” whose time has come. ●