



## GUARANTOR ANALYSIS GUIDELINES

### Revised 2026

#### INTRODUCTION

AHIC recommends that housing credit investors conduct a thorough review of the financial condition of the guarantor(s) of a low income housing tax credit investment as early as possible to ensure that the guarantee structure of the transaction is appropriate. These guidelines outline materials to be reviewed and highlight areas of analysis to be considered when evaluating the adequacy of a guarantor, be it an individual, a corporate entity (for-profit or non-profit), or a special purpose entity. Appendix I is a note on accounting; Appendix II contains excerpts from AHIC's Underwriting Guidelines that pertain to guarantor liquidity and net worth.

An investor's or syndicator's<sup>1</sup> review should include not only an examination of at least *three (3) fiscal years* of the guarantor's financial statements and tax returns, but also any related real estate owned (REO) schedule(s), contingent liabilities, background checks and statement of experience (see AHIC's Disclosure Form and REO Schedule, which are available at [www.ahic.org](http://www.ahic.org) under "Best Practices." **A guarantor analysis should explore the guarantor's primary line(s) of business and provide a comprehensive understanding of its ongoing operations and cash flow, not solely a review of the guarantor's balance sheet, which is merely a "snapshot" in time.**

**A comprehensive review of the guarantor's financial condition and business lines will determine whether alternate or additional guarantors and/or cash security is necessary to offset the risk that a guarantor is not able to meet its obligations.**

A LIHTC investor investing through multi-investor or proprietary (single-investor) funds typically does not have direct access to the CFO or controller of the guarantors. Therefore, the fund investor is reliant on the syndicator to thoroughly review the financial condition of the guarantor(s). A syndicator's analysis on behalf of an investor should be as thorough and detailed as that of a direct investor. As part of that analysis, the syndicator should clearly identify all materials that were reviewed.

Members of the Affordable Housing Investors Council have developed this resource for informational and educational purposes only. Nothing contained here should supplant an investor's individual analysis. Nor should it be construed as mandating any particular deal term.

While these Guarantor Analysis Guidelines can be used to identify and mitigate risks associated with individual transactions, following them will not necessarily lead to successful projects. The multiple dimensions of real estate success or failure are intertwined and complex.

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<sup>1</sup>This Guideline will use the term "Reviewer" to refer to both investors and syndicators who are undertaking the guarantor analysis.

**KEY TERMS/CONCEPTS**

1. **Liquidity** – Participants in the LIHTC industry commonly use this term to refer to assets on a balance sheet that are deemed unencumbered “cash and cash equivalents” in financial accounting. Cash equivalents are assets, such as marketable securities, commercial paper, treasuries and short-term government bonds, that are convertible to an equivalent amount of cash within 3 months or less. These represent assets that a guarantor could readily access or sell to cover construction overruns, operating deficits and other funding gaps. Cash equivalents would exclude assets with no observable or regularly tracked market prices that would allow an investor to independently assess the value of such assets.

**Note:** Cash and cash equivalents shown on a balance sheet are not the sole measure of a Guarantor’s ability to access cash for operations and obligations. First, such assets only represent cash available as of a single point in time and thus do not assess the guarantor’s ability to continue to produce cash over time. Second, such assets must be compared against offsetting current liabilities that the cash may be used to pay down, including outstanding balances on lines of credit.<sup>2</sup> Other measures of ability to access cash include cash flow from operations, debt service coverages, quick (“acid test”) and current ratios, developer fee payment schedules and lines of credit balances. However, calculations of ratios typically exclude assets and liabilities on a balance sheet from affiliates of the guarantor.

2. **Net Worth** – This term refers to the amount by which a person’s or company’s assets exceed its liabilities and may also be referred to as “owner’s equity,” or, for non-profits, “net assets.” For non-profits and government entities, the focus of the guarantor analysis should be on unrestricted net assets, meaning those guarantor assets that are not limited (by federal, state or local programs, donors or other restrictions) to certain uses and thus would be fully available to meet any guarantor obligation. However, public housing authorities may have the ability to utilize certain restricted assets, including subsidy reserves, for certain obligations (e.g., a public housing authority with a Moving to Work designation).

**Note:** Because GAAP accounting typically utilizes historical cost (adjusted for depreciation over time) for real estate and other assets, balance sheets do not reflect their appraised market value.<sup>3</sup> In addition, accounting consolidation rules can require assets to appear on a guarantor’s balance sheet that may not be fully available to the guarantor. For these and other reasons, most AHIC investors prefer to focus more on a guarantor’s cash and cash equivalents (“liquidity”), as well as sustainable cash flow (ability to produce cash over time). However, such cash and cash equivalents should typically only be those held in the name of the guarantor or wholly-owned entities.

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<sup>2</sup>Balance sheets may in some cases show net worth that is less than the cash and cash equivalents (liquidity) shown on the balance sheet. In these instances, the cash and cash equivalents may not be fully available for guaranty obligations because there are already existing balance sheet liabilities that may need to be paid down in the near term. Examples include a quarterly line of credit payment or other payables due to non-affiliates.

<sup>3</sup>For statements that have not been audited or reviewed by a CPA, the guarantor analysis should clearly identify the method of valuation used for assets on the balance sheet.

## PERSONAL GUARANTORS

Most AHIC investors prefer to secure personal guarantees for their LIHTC investments, along with corporate or other (e.g., trust) guarantees (see “Corporate Guarantees” and “Other Guarantees” sections). If a personal or corporate guaranty is backed by a guarantor whose financial condition is insufficient in relation to the investment’s risk profile, the investor must seek additional guarantors.

### RECOMMENDED SUBMITTALS

- **Personal Statement of Financial Condition** – Regardless of whether the guarantor is a repeat client, the reviewer should receive an updated personal statement of financial condition (balance sheet or “personal statement”) from each guarantor that is **no more than 6 months old** at the time of the investment closing. The guarantor should certify the personal statement, and the Limited Partnership Agreement’s (LPA) representations and warranties should include a representation that the information is accurate at the time of submittal.
- **Bank Statements** – The guarantor should provide bank/investment account statements to support the liquidity shown on the statement of financial condition. The reviewer should confirm that these accounts are held in the name of the actual guarantor for the transaction, or a wholly-owned affiliate. **AHIC recommends including any affiliate upon which the investor is relying for liquidity and net worth as a specifically named guarantor.**
- **Personal Tax Returns** – The reviewer should analyze **a minimum of three years** of personal federal tax returns, including supporting schedules (e.g., K-1s), to assess a guarantor’s history of sustainable income and outstanding tax liability (in relation to his or her liquidity).
- **REO Schedule** – The reviewer should ensure that the guarantor’s REO schedule is based on financial statements representing the same period as the most recent guarantor financial statement (see “Corporate Guaranty” guidelines below). See also AHIC’s Tools and Resources: [AHIC REO Schedule](#) and [AHIC Disclosure Form](#) for further guidance. The reviewer should also confirm the annual amount and cumulative payments the guarantor is making to support any developments. If the guarantor is using draws on operating reserves, insurance proceeds and/or GP (guarantor) loans, the reviewer should assess the ability of those sources or the guarantor to continue to support the development until the properties achieve breakeven operations.
- **Developer Fee Schedule** – The guarantor (or developer related to the guarantor) should provide the reviewer an up-to-date list of the guarantor’s pending and upcoming cash developer fees. This schedule should be prepared on a cash, not accrual (see **Appendix I – Basis of Accounting**), basis. In addition, the guarantor should certify that the schedule is accurate and that projected payments have been adjusted for any construction or other delays. The reviewer should compare these adjustments to the pre-stabilized property notes on the guarantor’s REO schedule.
- **Statement of Contingent Liabilities** – The guarantor should provide a statement of contingent liabilities that separates out construction loan and equity guarantees (at a minimum, completion and operating deficit guarantees). It should also tie to the REO schedule so that the reviewer can analyze the specific guarantees tied to pre-stabilized properties, particularly any that are experiencing delays and/or cost overruns, and when liabilities will be removed (e.g., stabilization

leads to release of completion guarantees, etc.). At minimum, the statement should include the amount of exposure relating to each construction loan guarantee (with current loan balances, expected repayment and loan maturity), equity completion and funding gap guarantees, and equity operating deficit guarantees. For guarantors with significant amounts of non-LIHTC pre-stabilized exposure, the reviewer should also inquire about guarantees relating to those non-LIHTC projects.

- **Background Checks** – It is important to conduct background checks on the guarantor, including lien and litigation searches, no sooner than 45 days prior to closing. Additionally, it may be desirable to commission updated background checks prior to upper tier closing based on the length of time the property has been warehoused. Some investors include background checks for spouses of guarantors; however, banking and credit regulations may constrain who can be included in background checks.

The reviewer should examine outstanding litigation and judgments (potential or actual) and other issues that arise on the background check that could have a negative impact on the guarantor's balance sheet.<sup>4</sup> The guarantor should sufficiently explain all outstanding issues and confirm whether any could materially impact the ability of the guarantor to honor its obligations. A statement that the guarantor believes it will prevail in the litigation or that any judgment will be covered by insurance is not sufficient.

#### ***Analysis Considerations:***

1. **Source of Funds.** The analysis should make clear how and where a guarantor makes his or her money (e.g., from developer fees, property management fees, construction fees, charitable contributions, land sales, etc.). An investor should understand whether the guarantor is a LIHTC developer with other lines of business, such as market rate units, or, for example, the guarantor is primarily a market rate developer.

**Note:** This recommendation is also applicable to corporate guarantees since the investor needs to understand the typical operations of the guarantor.

2. **Material Changes.** If the syndicator or investor has closed previous investments with the guarantor, the developer should explain material changes between the submitted statement of financial condition and those from prior years.
3. **Liquidity Calculation.** Each AHIC investor's institution will have internal guidelines as to which personal guarantor assets can be included in liquidity. Items typically **excluded** are:
  - Marketable Securities (maturities greater than 3 months)
  - IRA/Retirement Fund Accounts
  - Life Insurance Policies (cash value)
  - Trusts (if the guarantor is not the sole beneficiary<sup>5</sup>)

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<sup>4</sup>For audited statements, the reviewer should check the notes to see if the litigation or other issues are identified and discussed.

<sup>5</sup>For any material reliance on a trust, retirement accounts or cash value of life insurance for potential liquidity or net worth, the investor should seek legal assistance in determining whether such assets would truly be available in the event of litigation under the guarantees.

Some Investors may consider the inclusion of IRA/Retirement accounts if the individual Guarantor has reached the required age for withdrawals and such account balances have been adjusted for future taxes. However, such accounts should not represent a significant portion of overall liquidity.

**All adjustments to liquidity should be clear.** This is especially important if a syndicator is preparing the analysis, so that, as needed, the investor can make changes to align with company policy. Such adjustments may include a full deduction of the asset or a percentage reduction.

4. *Spousal Assets.* If the guarantor is married, **it is preferable to have the spouse as a named guarantor and a signatory on the statement of financial condition.** The reviewer should require an explanation if a spouse has not signed the guaranty agreement to ensure whether the assets shown to the reviewer could truly be available under the guaranty. In some instances, the state in which the agreement is executed may allow one spouse to pledge all marital assets on behalf of the couple (see Community Property vs. Common Law States discussion below). Alternatively, the guarantor may represent in writing that the balance sheet reflects only non-marital assets. A guarantor analysis should always clarify if a “haircut” has been applied to the assets to reflect a potential splitting of assets in the event of a divorce.
5. *Community Property vs. Common Law States.* Marital asset ownership is treated differently from state-to-state. Assets acquired during marriage while domiciled in a community property state are considered marital assets (i.e., community property). Where the couple currently resides determines which state’s laws apply. Community property states include Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin. In community property states, the reviewer should complete a credit analysis of both the guarantor and spouse. In addition, both parties should sign the guaranty or, at least, have the spouse sign an acknowledgment that the guarantor is signing the guaranty. Note that some states may also apply spousal rights to partners in a domestic partnership (the investor should consult with their counsel in instances where this may apply). All other states and the District of Columbia apply common law to asset ownership.

Under common law, assets owned by the guarantor and spouse can be considered separate property and thus the reviewer should ensure that he or she is reviewing only the guarantor’s share of assets. Finally, the reviewer should consult with counsel to ensure the guarantor analysis is in compliance with the Equal Credit Opportunity Act (ECOA). As it applies to this section, the ECOA prohibits credit discrimination on the basis of marital status. There needs to be an economic reason for the investment decision. For example, performing a credit analysis on the spouse in a common law state, and then rejecting the guaranty as a result, could be considered a breach of ECOA because, under common law, the spouse should have little effect on the creditworthiness of the guarantor.

7. *Real Estate Valuation.* In certain rare cases where liquidity is constrained, and no other additional guarantors are available, an investor may wish to seek supporting documentation (e.g., appraisals or broker opinions of value) for real estate assets that comprise the majority of net worth (see “Key Analysis Considerations” below for further discussion). The reviewer can then compare those
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values to the REO schedule to see if capitalizing (at a reasonable long-term cap rate) the cash flows shown going to the general partner will result in *roughly* similar values.

8. *REO Issues*. The AHIC investor should review the pre-stabilized properties on the REO schedule to determine if there is potential for any property to have a negative impact on future cash flow.

**Note:** The majority of REO schedules do not identify what portion of cash flow is available *after* LPA cash flow waterfall payments<sup>6</sup> and distributions to the limited partners. Therefore, the analysis should not identify the *total* net cash flow on the REO schedule as a potential source of cash, unless the reviewer has inquired about the underlying partnership agreements.

9. *Assessing Assets, Liabilities and Income*. The guarantor analysis should explain the *major* contributors to current assets, current liabilities, long-term assets, long-term liabilities and net worth. The goal is to clarify if assets or liabilities are potentially overstated. For example, any receivables or payables interrelated to other guarantors should be netted out.<sup>7</sup> In addition, to avoid “double dipping” the reviewer should net out (or at least clearly identify) any valuation of interests in any corporation, partnership, trust or other entity that is also serving as a separate guarantor.

The guarantor analysis should also explain the major contributors to taxable income (from federal returns). This analysis should also address material issues in Schedules C and E as they relate to the guarantor’s REO schedule and related businesses (development, general contracting and/or property management companies).

## CORPORATE GUARANTORS

### RECOMMENDED SUBMITTALS

- **Fiscal Year End (FYE) Financial Statements** – AHIC recommends reviewing a minimum of three consecutive FYE financial statements for all guarantors prior to closing a transaction. Three years of statements that cover the same accounting period and use the same accounting method are necessary for sufficient trend analysis. AHIC’s recommended level of assurance on financial statements is in the following order:

1. Unqualified audit<sup>8</sup>
2. Review
3. Compilation
4. Internally Prepared

If the most recent final or draft FYE statements are not yet available, AHIC recommends reviewing the three most recent statements and requiring that the final statements be provided as part of any ongoing financial statement covenant reporting.

- **Interim (Partial Year) Statements** – Interim statements should be provided in addition to FYE statements, but are not a replacement for FYE statements. Interim statements are typically

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<sup>6</sup> However, it may be possible to ascertain what portion of cash flow may go to deferred developer notes, which will likely be ahead of soft loan payments in the cash flow waterfall.

<sup>7</sup> Since personal statements are not audited or reviewed, they typically do not reflect the elimination of related assets and liabilities that are applied in GAAP statements.

<sup>8</sup> Any qualification to an audit opinion must be explained

company-prepared and may not utilize the same accounting methods as FYE statements, making trend analysis difficult. If interim statements are utilized, AHIC recommends that they be for a period of not less than 9 months to cover typical seasonal changes in income and expenses.

### ***Analysis Considerations***

1. ***Statement Type.*** AHIC recommends audits (unqualified opinions) or at the least reviews,<sup>9</sup> particularly for investments that do not include personal guarantees and rely solely on corporate or other entity (e.g., trusts, partnerships, limited liability corporations) guarantees. Highlight any differences in the basis of accounting used by the guarantor, or any other change in the guarantor's accounting methods or policies that have a material impact on the representation of the balance sheet, income statement and/or cash flow statement (see **Appendix I: Basis of Accounting**). If an audit is not provided, the reviewer may seek more supporting detail and documentation. For example, if the guarantor provides only internally prepared financial statements, bank/investment statements can be used to verify liquidity and tax returns can be used to verify annual income and outstanding tax liability.
2. ***Liquidity Calculations.*** Each AHIC investor's institution will have internal guidelines as to what assets can be considered as cash and cash equivalents. Items to consider eliminating or reducing from calculations of cash equivalents for corporate entities (for-profit or non-profit) include:
  - Long Term Marketable Securities
  - Restricted Cash Contributions/Donations
  - Restricted Reserves
  - Restricted Government Grant Funds
  - Tenant Security Deposits

As noted above, the guarantor analysis should clearly note any such adjustments, especially if a syndicator is preparing the analysis, so any changes to conform to an investor's internal policies can be made easily.

An investor may also wish to consider assessing working capital, cash flow from operations and other financial ratio calculations<sup>10</sup> as further measures of a guarantor's ability to access cash. However, prior to such calculations, the reviewer should make adjustments for related party receivables and payables. As discussed previously, such assets must also be compared against offsetting current liabilities that the cash may be used to pay down, including outstanding balances on lines of credit.

3. ***Assessing Assets, Liabilities and Income.*** The guarantor analysis should explain the major contributors to current assets, current liabilities, long term assets, long term liabilities, net worth, gross and net income and cash flow from operations. All assets, particularly receivables, comprising the majority of net worth should be explained. For unaudited statements, eliminate any related party receivables, such as deferred developer fee notes, notes receivable from the owners,

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<sup>9</sup>See the following for a further discussion:

<https://www.aicpa.org/interestareas/privatecompaniespracticesection/qualityservicesdelivery/keepingup/what-is-the-difference-between-compilation-review-audit.html>

<sup>10</sup>When calculating traditional liquidity measures involving debt, the reviewer should take into account that LIHTC developers may have large amounts of soft debt on their balance sheet, which may result in ratios that overstate leverage. See **Appendix I – Basis of Accounting** for further discussion.

or company-funded predevelopment loans.<sup>11</sup> Similarly, ensure that liabilities are not overstated due to notes payable to the owner and other similar related-party liabilities that would *not* be due if cash were otherwise needed for guaranty obligations.

4. *Lines of Credit.* It is important to confirm the outstanding balances of all lines of credit and compare that against liquidity and current assets only. Note whether the line is typically (or must be) paid down at the end of each year or has a cure period. If relevant, determine why the balance has been growing; this could suggest a growth in business development or possibly liquidity concerns.
5. *Guarantor Structure.* The specific structure of the guarantor and whether it is a parent of subsidiaries/affiliates or a subsidiary/affiliate itself must be clear. If it is a parent, the reviewer should confirm whether it is a 100% owner of the subsidiaries included in its financial statements or whether it solely owns a controlling interest.<sup>12</sup> A controlling interest of less than 100% may mean the named guarantor does not have unfettered access to the subsidiary's assets, even in the case of a judgment secured against the parent. **If a Guarantor's balance sheet, particularly its cash and cash equivalents, are centered in any subsidiary, the investor should require that subsidiary to also be a direct party to the guaranty agreement.**

**Note:** Reviewers should take note of consolidated statements that show the combination of two or more entities with common ownership (i.e., both 100% owned by an individual), but with no corporate or personal controlling owner that is also a named guarantor. In such cases, it is important to specifically name all such consolidated entities as guarantors when possible. Otherwise, the supplemental schedules to the consolidated statements must be analyzed to assess the stand-alone creditworthiness of the named guarantors.

6. *Distributions/Contributions.* For guarantors showing limited liquidity, and/or those providing unaudited financial statements (which typically do not include a cash flow statement), AHIC recommends review of the guarantor's federal tax returns (including Form 1065 and 1120S Schedules K, L, M-1 and M-2) to analyze distributions to and contributions from the owners of the guarantor. This is particularly important for S-Corporation and partnership guarantors that are pass-through entities for tax purposes and often keep limited cash and cash equivalents on hand, unless required to do so by lenders or investors.
7. *Covenants and Reporting.* AHIC recommends requiring liquidity and net worth covenants in the LPA. **See Appendix II: AHIC Underwriting Guidelines on Liquidity and Net Worth.** The guarantor should also be required to provide financial statements and, if requested, bank/investment statements twice per year during construction and once per year thereafter following each fiscal year end. There should be ramifications under the LPA for failure to meet the covenants or voluntarily filing for bankruptcy. For example, failure to provide financials or meet the covenants could result in financial penalties that accrue to the LP and are repaid on the backend. Often, bankruptcy is a removal event under an LPA, at least during the pre-stabilized period.

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<sup>11</sup>GAAP-based statements will include such eliminations.

<sup>12</sup>Due to variable interest rules (see **Appendix I – Basis of Accounting**) rules, a guarantor may be required to include the full amount of assets and liabilities, including cash and cash equivalents, of a subsidiary in which it owns less than 100% of the subsidiary's interests.

However, the developer may be allowed to provide a substitute guarantor to cure such a default, with the new guarantor subject to investor approval at its sole and absolute discretion.

8. *General Contractor Guarantors.* The reviewer should pay special attention to the liquidity of guarantors that are general contractor entities to ensure the reviewer fully understands their cash position and ability to generate cash. General contractors may show high amounts of cash and cash equivalents by delaying payment to material suppliers and subcontractors, which should show as offsetting outstanding payables. Be aware of large billings in excess of costs, which may also suggest the contractor is increasing cash flow by front loading billing to owners for materials and other costs. Alternatively, general contractors may have arrangements where they pay their subcontractors on a specific date each month, before the general contractors have billed the owner. Such general contractors will show a smaller cash and payables balance, but a much higher receivable balance. The intent of such general contractors is to ensure their subcontractors are satisfied and do not walk to another job because of delayed payments.

## CAPITALIZED SPECIAL PURPOSE ENTITIES (“SPE GUARANTORS”)

Single-Purpose Entities are corporate entities employed as mechanisms to legally and financially isolate key principals and/or parent companies from liabilities (including those associated with the guarantees being provided). They may have less robust histories and financial documentation than operating companies and may therefore be more challenging to evaluate. Consider limiting the number and amount of guarantees to be provided by an SPE and capitalize the SPE with appropriate cash reserves and springing guarantees. **Because it is easy for a guarantor to pull funds out of an SPE, the guarantee agreement should include minimum net worth and liquidity requirements that remain in place during the compliance period.** See Appendix II for thresholds recommended by AHIC. Calibrate the amounts according to the specific risks in the transaction; an investor may wish to consider higher requirements for guarantors that do not have an ongoing ability to generate cash.

### RECOMMENDED SUBMITTALS

Generally, SPE guarantor submittals should follow those for corporate guarantors. Although the developer is not specifically the guarantor, the guarantor analysis should still provide the reviewer a strong understanding of the developer’s overall financial position and ability to support the proposed investment. This is particularly important so that the reviewer can assess the ability of the developer to recapitalize the SPE guarantor should there be a call on its obligations.

#### *Analysis Considerations*

1. *Contingent Liabilities.* The Guarantor analysis should closely analyze the SPE guarantor’s current and expected contingent liabilities, if that entity is already guaranteeing or will be guaranteeing more investments than just the currently proposed investment.
2. *Sources and Uses of Cash.* The guarantor analysis should clarify any recurring sources of cash that will be available to the SPE guarantor. Typically, the developer will offer a one-time capitalized SPE guarantor that will not have ongoing access to new cash. For any capitalized SPE guarantor with no recurring source of cash, any required reporting to the investor should identify any actual or expected draws on the SPE guarantor’s cash balance.

3. *Covenants.* AHIC recommends that the SPE guarantor have strict liquidity covenants and that any guaranty agreement clearly state (1) what assets can be included as liquidity and (2) the adjustments to liquidity to account for any expected liabilities during the term of the guaranty.
4. *Financial Reporting.* AHIC recommends that the financial reporting requirements (including bank/investment statements) be stricter for a SPE guarantor that supports more than one investment than reporting requirements for a corporate guarantor. While audited statements should be provided once per year, the Investor may seek to require company prepared statements and supporting bank/investment statements at least twice per year during both the construction and permanent phase of the investment.
5. *Covenant Default/Bankruptcy.* AHIC recommends that the SPE guarantor's failure to meet a covenant or its voluntary or involuntary bankruptcy should, *at minimum*, lead to GP removal. Preferably, a bankruptcy during construction should lead to the investor's option to repurchase. In either case, there can be a limited cure period for the developer to re-capitalize the SPE Guarantor or provide a new Guarantor acceptable to the investor at its sole and absolute discretion. The investor may also wish to seek a "springing guaranty" from a corporate guarantor that applies in the event of bankruptcy caused by the SPE guarantor's obligations on other transactions.

## APPENDIX I – Basis of Accounting

Guarantor financial statements (other than those for individuals) are typically provided in one of the following forms:

- Accountant Audit (Unqualified highly preferred)
- Accountant Review
- Accountant Compilation
- Company Prepared
- Federal Tax Return

Developer financial statements typically use either U.S. Generally Accepted Accounting Principles (“GAAP”) or accounting for federal tax purposes (“tax accounting”), which will then either be typically based on “cash basis” or “accrual basis” principles.<sup>13</sup> Few statements that an investor will see will utilize cash basis. Some statements will utilize a “modified cash basis” method, which allows for some use of accrual concepts, namely inclusion of receivables and payables on a balance sheet (a true cash basis statement would not include these items).

There are typically two reasons why a guarantor may elect to use tax accounting rather than GAAP.

- **Cost Savings** – If a developer is relatively small in terms of annual revenue and is not being required by its lenders or Investors to provide GAAP-based statements, to save money its accountants can utilize the same accounting for the developer’s tax returns (e.g., Schedule M-1 and M-2 from an IRS 1065 Form) and the (unaudited) financial statements.
- **Variable Interest Entity (VIE) Consolidation** – The developer may prefer to use tax accounting to avoid consolidating the full assets and liabilities of the real estate (including LIHTC) partnerships or LLC it controls onto its financial statements, which is required under current GAAP variable interest entity (VIE) rules. Some developers believe consolidation unnecessarily overcomplicates their financial statements (e.g., showing high leverage due to the inclusion of large amounts of soft debt from LIHTC transactions) and misrepresents their financial condition. As an alternative, some developers use GAAP accounting, but do not consolidate such entities and accept that their accountants will provide a “qualified opinion” in noting that the audit does not conform to GAAP with respect to these consolidation rules. When a *qualified* GAAP Audit is provided due to VIE rules not being applied, the audit often provides in the notes what the balance sheet would look like if the VIE rules are applied. If such an analysis is not provided in the notes, the reviewer may wish to seek clarification from the auditor.

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<sup>13</sup>See the following for a further discussion:

<https://www.investopedia.com/ask/answers/09/accrual-accounting.asp>

## **APPENDIX II – AHIC Underwriting Guidelines on Liquidity and Net Worth**

*The following guidance on guarantor liquidity and net worth is excerpted from AHIC's Underwriting Guidelines, the full text of which is available at [www.ahic.org](http://www.ahic.org) on the Best Practices page in the Underwriting section.*

Investors must have confidence that guarantors have the financial capacity and willingness to support a project that experiences delays, cost overruns or extended time to achieve completion or stabilization.

Benchmarks may inform expectations, liquidity and net worth requirements should be tailored to project characteristics and sponsor profiles. Uniform financial covenants should not be applied by default.

The guarantor should have sufficient liquidity and net worth to provide financial support and cover their obligations based on the size and scope of the project. AHIC recommends:

### **Factors to consider when determining liquidity and net worth requirements**

- **Project Level**
  - Equity commitment and timing of contributions
  - Sources & Uses –
    - Is the sponsor providing capital
    - Does the sponsor have the financial capacity to support the project if issues arise
    - Does the sponsor have the financial capacity to potentially resize/reduce the perm loan
  - Total development costs
  - Repurchase, OERDS, Structure, Complexity, Basic Underwriting Contingencies
  - Investor exposure attributable to respective sponsor relationship
- **Guarantor Financial Capacity**
  - **Balance Sheet and Income Statement:**
    - Liquidity, contingent liability levels and the probability of calls on contingent guarantees, including ODGs, tax credit guarantees, and recourse obligations
    - Consideration should be given to the overall liquidity level and potential demands on the liquidity position when setting the covenant requirement,
    - Business lines and their respective contribution/drag on earnings- for instance development vs property management vs builder's profit
    - Pledges of receivable developer fees
    - Recurring cash flows
  - **Real Estate Owned (REO)**

- Portfolio size, and expected contribution/drag on Balance Sheet and Income Statement from deals in pre-construction, construction, lease-up, and stabilization.
- Track record of performance with an emphasis on T12-24, complexity and status of each or notable deals in the portfolio including pipeline with an emphasis on watch-list.
- Age/maturity of the portfolio with an emphasis on number, status, and contribution/drag on NW and Liquidity of deals below 1.0x, and adequacy of property level reserves.
- Mitigants to weaker guarantor profiles may include implementing additional safeguards such as development fee holdbacks, cash reserves, and Letters of Credit securing the guarantee obligations, or a combination of these.
- *Liquid assets* include cash, cash equivalents, and assets that can be converted to cash in a short time with little or no loss in value, including U.S. treasuries, mutual funds, money-market funds, and stocks; however, if a significant portion of the liquidity is tied to stocks, it is important to consider whether the value of these securities has changed materially since the date of the financial statements; retirement accounts should be excluded from the liquidity calculation due to penalties associated with early withdrawals., the owner could face significant income taxes upon withdrawal. Also, retirement accounts generally are protected from creditors. These can be strong disincentives by the owner to voluntarily withdraw retirement funds outside of a normal sequence based on age (**all submissions should include verification of liquid assets**).
- Construction liquidity of 15% for new construction and 25% for rehabilitation projects (construction liquidity is calculated as the sum of (1) cash development fee held back until 100% completion, (2) hard cost contingency, and (3) guarantor liquidity divided by hard cost construction costs); **when guarantor liquidity is excluded from the construction liquidity calculation above, AHIC recommends liquidity of 12% for new construction and 20% for rehabilitations**