Understanding Tax Abatements
including Exemptions and PILOTs

What is a tax abatement?

Properties that have been developed or redeveloped under a state or local economic development program often qualify for some reduction in their real property taxes. This may be in the form of a:

- Tax abatement or exemption – a reduction of or exemption from taxes, granted through a governmental body (typically local government)
- Payment in lieu of taxes (PILOT) – a payment made to compensate a local government for some or all the real estate tax revenue that it loses because of the nature of the ownership or use of a property

The terms of the tax abatement are established by the taxing authority or governing body granting the abatement. The abatement may require the owner and/or the property to meet certain criteria. The abatement may be forfeited if the owner and/or property do not comply with the terms of the abatement.

Our tax abatement policies apply to properties being financed through our Conventional or Targeted Affordable Housing (TAH) products.

What are the benefits of a tax abatement when underwriting a mortgage purchase?

Due to the reduction in taxes for a specific period, we may consider using the reduced real estate tax payments for the property in our underwriting after we receive and evaluate information regarding the tax abatement.

How is eligibility of a tax abatement determined?

The tax abatement must be found eligible by Freddie Mac at both the program and property level. A list of approved individual state and local tax abatement programs is available on mf.freddiemac.com.

If the state or local tax abatement program has not already been approved, a questionnaire for program-level approval is available on the Multifamily Legal Documents webpage, Miscellaneous section, detailing the information that must be provided before issuing a commitment or accepting an early rate-lock application.

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If a tax abatement program is not on the list of approved tax abatement programs, the tax abatement may still be eligible to be used in the underwriting of the loan. A more detailed analysis of that tax abatement must be provided in the underwriting package.

How does the tax abatement impact the appraisal?

As stated in the *Multifamily Seller/Servicer Guide* (Section 60.23: Collateral evaluation for tax abatement), the preferred valuation methodology is as follows:

- First, full, stabilized real estate taxes are used to calculate the net operating income (NOI) that is used to determine the property value with full taxes.
- Next, the present value of the tax savings over the term of the tax abatement is determined using a discount rate supported fully by the appraiser.
- The present value of the tax savings is then added to the property value with full taxes to determine the value of the property with the tax abatement.

The appraiser must demonstrate in the appraisal that the tax abatement is likely to continue for its stated term. This can be accomplished by a variety of methods, including a review and discussion within the appraisal of the tax abatement agreement and/or documented conversation and confirmation of the tax abatement by the appraiser with the local property tax authority or tax abatement-granting agency.

Evidence of tax abatement

As stated in the *Guide* (Section 8.19(b): Tax Abatement eligibility and Section 55.2: Requirements for documents contained in the underwriting package), for properties benefiting from tax abatements, the Seller must provide documentation from the taxing authority or the governing body confirming each of the following:

- Verification that (i) the tax abatement program agency has been approved by Freddie Mac or if previously approved that no material changes to the tax abatement program have been made since approval; and (ii) the applicable statue for the tax abatement must be in force at the time the full underwriting package is submitted to Freddie Mac; and (iii) the tax abatement will continue as stated during the term of the loan.
- That the property or the Borrower, as applicable, has qualified for the tax abatement (e.g., a certificate of eligibility or letter from taxing authority or the governing body granting or confirming the abatement or a copy of the borrower's current tax statement showing the amount of taxes assess). If the tax abatement is subject to a periodic review and/or reporting, evidence that the renewal and/or reporting is current.
- The amount of annual tax to be paid, if any.
- The term of the tax abatement.
- Any other requirements of the tax abatement.

Specific guidance is available in the Tax Abatement Exemption PILOT Questionnaire document available on the Multifamily Legal Documents webpage – Miscellaneous section. The Questionnaire also accounts for programs that may not have been previously approved by Freddie Mac.

Calculating the Debt Coverage Ratio (DCR)

A refinance test will be given for all loans with tax abatements. The refinance test is as follows: (i) the refinance period will be equal to the 10 years following the maturity date of the loan; and (ii) the loan must meet the DCR and loan-to-value ratio (LTV) of the standard refinance test.

A property with a tax abatement must be analyzed under one of following two scenarios:

1. If any of the following facts exist, then the abatement is considered “Infinite”: (i) the phase-in period, if any, begins at least 10 years after loan maturity; (ii) the abatement runs for 20 years after loan origination; or (iii) the abatement runs for the full term of a fully amortizing loan. If the abatement is considered “Infinite,” abated taxes will be utilized to derive the NOI and to run the Refinance Test.
2. For all other loans, the underwritten NOI will include the tax expense based on the actual in-place taxes, whether fully or partially abated. A cash flow analysis must be performed to show the effect on NOI of any decrease in the tax abatement for the term of the loan plus 10 years.

For assumptions to be used in this analysis and for DCR requirements over the loan term, please contact your Freddie Mac representative.