Finance

SIDs: More attainable housing through lower cost of capital

The cost of development has continued to increase in recent years, which is one of the many reasons why Colorado finds itself in an affordable housing crisis. Developers and homebuilders also take on significant financial risk at the front end of master planned community development, limiting the supply of housing in the market. Building off our company's 40-year history of developing innovative solutions to financing challenges, we have created or adapted a number of tools to address these issues for new communities. One such tool is the special improvement district, an alternative to traditional development loans for residential and commercial projects in the state.

The special assessment tool had historically been used by cities and counties as a means of financing specific, generally small-scale, infrastructure within communities. Thanks to legislative changes in 2016, SIDs can now be formed by a broader set of local governments in the state of Colorado. SIDs created by metropolitan districts can be an attractive alternative to traditional land-secured debt for developers and homebuilders. This arrangement has numerous advantages:

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1.) It allows for a lower cost of capital because a SID can borrow at tax-exempt rates, in the range of 5% to 6% currently, as compared to 8% to 10% from traditional lenders and more from equity sources.

2.) Recourse for an SID is limited to the lien created by the special assessment, with no personal or corporate recourse to the developer or property owner, meaning the SID carries less risk.

3.) SIDs offer financing for up to 20 years, longer than a typical development loan, which helps to alleviate pressure on the developer.

4.) Borrowers pay down only the lien amount when each lot is sold. They are not required to use all lot sale proceeds to pay down the loan until fully repaid like a traditional development loan.

Piper Sandler has worked with numerous developers and homebuilders to put in place attractive terms for SID financings across the Front Range.

Tryba Architects

The financing at Fox Park is the first of its kind in Colorado.

Dream Finders Homes was the first national production homebuilder in Colorado to benefit from the SID tool at the Looking Glass community in Parker. SID Nos. 1 and 2 will contain 759 single-family homes. Dream Finders will ultimately be finishing lots for a total of 1,795 homes throughout the community with base home prices ranging from the low $500,000s to the $800,000s. The metro districts at Looking Glass funded the project's major trunk improvements, leaving the SID issuances to fund in-tract public improvements in the most efficient manner possible.

Sterling Ranch is a 3,400-acre master planned community in Douglas County that has been the No. 1 selling master plan in Colorado since 2020. A future phase of Sterling Ranch called "Legends Village" consists of 188 acres with development planned for 628 single-family attached and detached homes along with 264 for-rent, 90% of AMI multifamily units. This issuance combined both the metro district ad valorem property tax financing with the special assessment tool at the same closing to provide a significant portion of the funding necessary to construct the improvements to deliver finished lots to homebuilders.

Commercial projects can also benefit from the use of SID financing. The mixed-use Denver infill project known as Fox Park previously issued bonds backed by ad valorem property taxes. The developers were looking to generate proceeds for additional public infrastructure improvements in a cost-effective manner with more favorable terms than traditional bank financing. Fox Park formed an SID that contains five parcels of commercial land planned to be developed into 1,400 multifamily units, 452,000 square feet of commercial space, and a 280-key hotel. The financing at Fox Park is the first of its kind in Colorado, demonstrating that assessment lien financing can benefit commercial property in the state on a large scale.

For developers and homebuilders, the SID tool can be an attractive alternative relative to other sources of early stage capital given its many benefits – lower rates than traditional bank capital, lack of personal or corporate recourse, longer terms than traditional financing, and paydown of only the lien amount with each lot sold. Lowering up-front equity commitments from developers and removing some of the financial risks in the process speeds up development and allows more attainable housing to be built, which we desperately need in Colorado. ▲

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1031 Exchange

1031 exchanges: Taking advantage of market conditions

Due to many factors, including the rise in interest rates, our Colorado commercial market has been challenged, however, it is currently flush with excellent opportunities for real estate investors with cash to spend. To fund these lucrative deals, the investor may have a sale of a relinquished investment property in place (or ready to be marketed soon) that they intend to put in a 1031 exchange. With careful planning and either a delayed or reverse exchange, savvy real estate investors can take advantage of both a market full of amazing purchasing opportunities and capital gain tax deferral.

In a 1031 delayed exchange, the investor has 45 calendar days from closing on the sale of a relinquished property to identify replacement properties, pursuant to the rules of identification. This 45-day period is referred to as the "identification period." Some frequently asked questions are: Can the investor begin looking for suitable replacement property before closing the sale of the relinquished property? And can the investor make offers on and get replacement property under contract before closing the sale of the relinquished property? The answers to these questions is "yes."

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Although the start of the identification period is triggered by the relinquished property sale closing, nothing prohibits an investor from looking for replacement property before the relinquished property sale closes. In areas where inventory is limited and/or favorable properties sell quickly, it can be a wise strategy to begin looking for replacement property once the relinquished property is under contract with a qualified buyer, or even before. The additional time before the relinquished property sale closes provides the investor more time to locate suitable replacement property.

Having a contract on a replacement property before the relinquished property sale closes can be proactive and remove much of the uncertainty from the delayed exchange process. The investor should be sure to close the sale of the relinquished property before it must close the acquisition of the replacement property, or it may be in position for a reverse 1031 "parking arrangement" exchange (see below for more information). The delayed exchange timeline allows the investor 180 calendar days from the date of the relinquished property sale closing to close on the acquisition of identified replacement properties. If the investor closes on the acquisition of any replacement properties within the 45-day identification period, those properties are considered identified for 1031 exchange purposes.

In the event an investor locates a desirable replacement property and wants to close on that acquisition before the relinquished property sale closes, a reverse 1031 "parking arrangement" exchange is possible. There are additional costs and complexities involved with reverse exchanges, so this type of exchange often makes sense on larger purchases when the higher fees are more than offset by the value of the replacement property acquisition.

In this situation, real estate investors can defer their capital gain taxes and obtain safe harbor treatments by utilizing Revenue Procedure 2000-37, which provides guidelines for a reverse parking arrangement exchange. Rev. Proc. 2000-37 makes it clear that the investor cannot own both properties at the same time. It describes the ownership process as a "parking arrangement" because either ownership of the relinquished property or the replacement property is "parked" with an exchange accommodation titleholder. To park the ownership means a deed is recorded transferring ownership to the EAT, thereby the investor owns one property and the EAT owns the other.

■ **Parking the replacement property.** The EAT acquires title to the replacement property with funds that the investor loans to the EAT. Within 180 days, the investor sells the relinquished property and the EAT transfers the replacement property to the real estate investor.

■ **Parking the relinquished property.** The investor conveys the relinquished property to the EAT and then acquires the replacement property under a simultaneous exchange format. During the 180-day exchange period, the EAT remains on title to the relinquished property until it is sold to a purchaser.

■ **Reverse/improvement exchange.** The EAT acquires the replacement property and makes improvements to this property. The improved replacement property is later exchanged for the relinquished property within 180 days to complete the exchange.

When contemplating any type of 1031 exchange, consulting with a tax adviser and exchange professional in a timely manner is essential, and this is particularly important when considering a more complex parking arrangement exchange transaction.

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