Year 15: Transition Strategies for Expiring LIHTC Properties

May 31, 2018 Enterprise Live Online Event

Presenters:

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National LIHTC Stock: nearly 3 million units

- Urban, suburban and rural markets across the country
- Housing for families, seniors, people with special needs
- Deep affordability: 64% of residents are at or below 40% of AMI, according to HUD
- Extended use expiration is approaching, will be a rising wave in coming years

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ENTERPRISE'S EXPERIENCE TO DATE

Over 900 Projects transferred or approved

Projecting in excess of 100/year over the next 5 years.

OBJECTIVES OF THE TRAINING

- Understand background on Year 15
- Discuss key exit options, including ROFR and buyout options
- Understand perspectives of stakeholders
- Resyndication
- Capital Accounts and exit taxes
- Learn how to develop an action plan
- Review Case Studies

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THE YEAR 15 PROCESS

- Step 1: Know the Property
- Step 2: Know your partners and stakeholders
- Step 3: Know your documents
- Step 4: Develop your plan

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THE STAKEHOLDERS

- Residents
- General Partners/Sponsors/Developers
- Investors
- Syndicators
- Private Lenders
- Public Lenders
- Allocating Agencies
- The IRS

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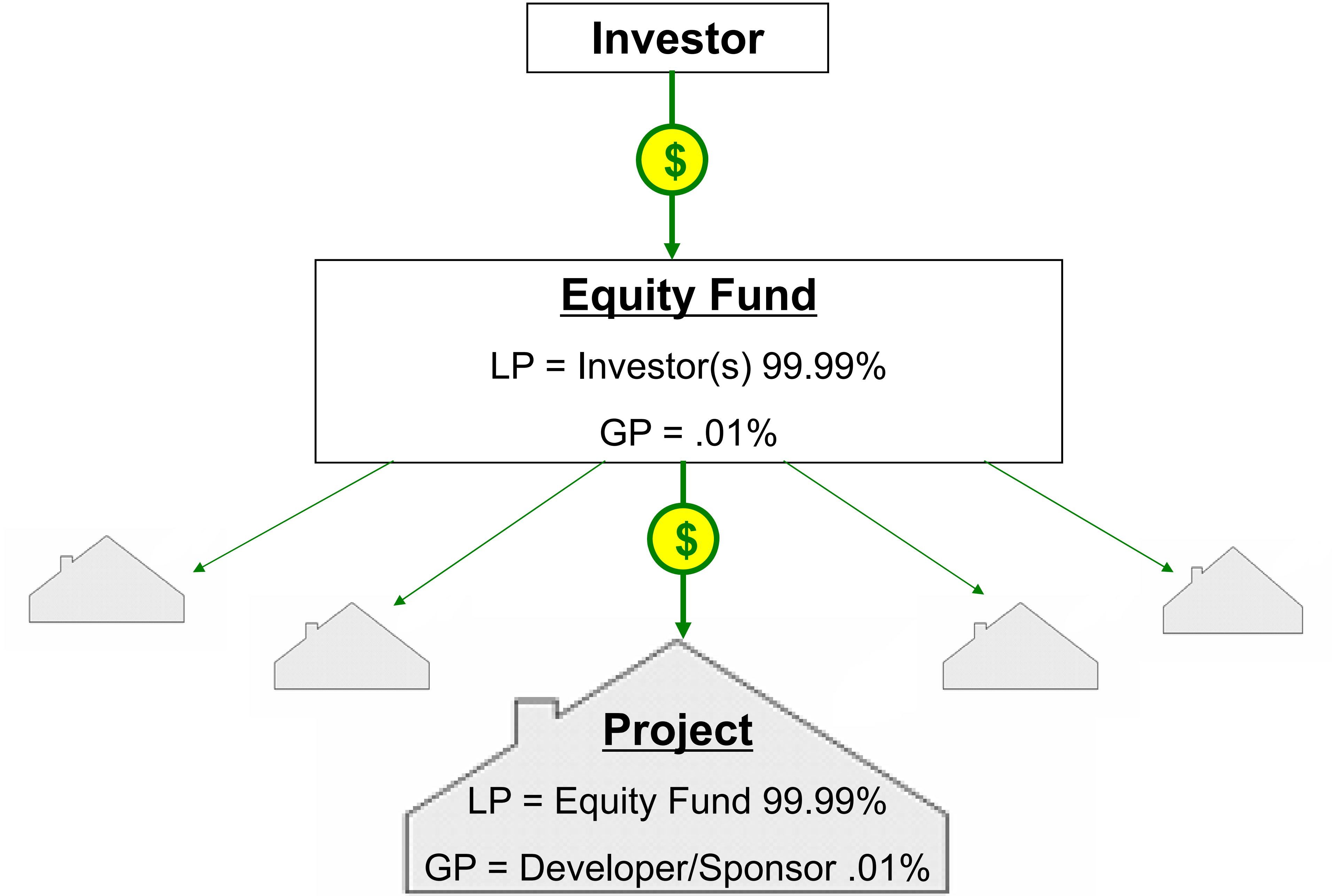
Investor
$
Equity Fund
LP = Investor(s) 99.99%
GP = .01%
$
Project
LP = Equity Fund 99.99%
GP = Developer/Sponsor .01%

STRUCTURE OF LIHTC INVESTMENTS

- Investments are sold through Limited Partnerships and LLC's

- Partnership Agreements control dispositions, providing:
  - Transfer restrictions and price
  - Consent requirements
  - Distribution of Proceeds
  - Liquidation and Dissolution

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TYPES OF INVESTORS

Types of Investor vary:

- Direct Investors
- Syndicators (“Intermediaries”)
  - Single Corporate Investor Funds
  - Multiple Corporate Investor Funds
  - Multiple Individual Investor Funds

Types of Syndicators vary:

- National for-profit
- National nonprofit
- Regional (mostly nonprofit)

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ENTERPRISE'S GOALS

- Deliver Expected Investor Benefits
- Exit investor in Year 16
- Transfer to Sponsors
- Works with the sponsor to develop its Year 15 transition plan
- Preserve affordability
- Minimize displacement of low-income residents
- Preserve project viability
- Can provide equity to resyndicate the project with new tax credits
- Can provide debt to refinance the project

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EXIT STRATEGIES: POSSIBLE SCENARIOS

- Right of First Refusal to purchase property
- Buyout option to purchase partnership interest
- Bargain Sale
- Purchase within compliance period ("Early Exit")
- "Puts": Obligation to Purchase
- Sale to 3rd party

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RIGHT OF FIRST REFUSAL

Formula Price = Debt plus Exit Taxes

Issues with Right of First Refusal:

- Is a bona-fide 3rd party offer required?
- Reserves not included
- Transaction costs
- Formula Price may exceed fair market value

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BUYOUT OPTION OF PARTNERSHIP INTEREST

Typically, option price is <u>greater of</u>:

- Fair Market Value of Partnership Interest (defined as sale of property and liquidation of partnership)

Or

- Unpaid Benefits plus Exit Taxes

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EARLY EXIT

- Investor can dispose of its interest prior to Year 16, provided:
  - LIHTC compliance is maintained
- Early exits may not be feasible for multiple investor funds
- An indemnity agreement is required to protect the exiting investor and syndicator may retain rights to access property and files through Year 15

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LP CAPITAL ACCOUNT

- Balance is comprised of:
  - Capital Contributions
  - Less: Distributions
  - Less: Taxable losses
  - Less: Historic Credits (if applicable)
  - Less: syndication cost
- By definition, LP Capital cannot be negative unless Minimum Gain exists
  - Nonrecourse debt
  - Less net book value of assets
- Tax basis, not GAAP

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LP CAPITAL ACCOUNT (Cont'd)

- Must zero out upon transfer of interest
- If the ending balance is positive, a loss will be recorded as the investment is written off
- If the ending balance is negative, a gain will be recorded as the benefits exceeded the investment
  - Triggers "exit taxes"
  - Time value of money

EXIT TAX EXAMPLE

- Sales price equal debt + exit taxes
- LP has a capital account balance of ($500,000)
- Exit tax = $500,000 x 35% (federal rate) = $175,000
- The payment of the exit taxes by the GP creates another taxable event
- $175,000 x 35% = $61,250
- Total exit taxes $175,000 + $61,250 = $236,250 OR
- Apply “gross up” factor: 1 + tax rate ($175,000 X 1.35 = $236,250)

ACTION PLAN FOR PURCHASERS

YEARS 10-13:

- **Develop strategic plan:**
  - Through Year 15
  - After Year 15

- **Determine when compliance period ends**

- **The GP Perspective**
  - Does the GP have the desire and capacity to purchase the project?

- **Investor Perspective**
  - Is the Investor flexible with sale or transfer?
  - Were Investor benefits realized?

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ACTION PLAN FOR PURCHASERS

YEARS 10-13:

- **Review current performance and develop projections**
    - Will cash flow be sufficient to sustain future operations?
    - Are there any anticipated changes in the budget, such as loss of rental subsidies or tax abatements?

- **Market Conditions**
    - Is the project marketable?
    - Is there competition from other projects?

YEARS 10-13:

- **Review capital needs**
  - Is there a Capital Needs Assessment (CNA)?
  - Consider a Green CNA
  - What are reserve balances and restrictions?

- **Review and project capital account and exit taxes**
  - How will exit taxes be handeled?

ACTION PLAN FOR PURCHASERS

YEARS 13-14:

- **Analyze Partnership Debt**:
  - How does public purpose debt impact disposition? Additional extended use, reserve restrictions, policies for consent
  - Are balloon loans or deferred interest payments due at or immediately after Year 15?
  - Does existing debt exceed fair market value?
  - Can loans be assumed, forgiven or restructured?
  - Lender affordability restrictions
  - Lender approval rights

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ACTION PLAN FOR PURCHASERS

YEAR 13-14:

- **Determine Likely Purchase Price**
  - Per Buyout Option or Right of First Refusal
  - Does the price make sense?
- **Explore Sources of Funds to Meet Purchase Price and Capital Needs:**
  - Refinance: Conventional debt or soft loans
  - Reserves
  - Combinations
  - Weatherization
  - Grants

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ACTION PLAN FOR PURCHASERS

YEARS 14-15:

- Consult with Accountant and Attorney
- Meet with Syndicator
- Negotiate Purchase Price
- Sign Letter of Intent
- Obtain Lender Approvals
- Draft Legal Agreements

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ACTION PLAN FOR PURCHASERS

YEAR 16:

- Close on purchase in 1st quarter of year 16
- File amended Certificate of Limited Partnership (if applicable)
- File tax return and provide final K-1 to Limited Partner(s)
- Execute an amendment to the Partnership Agreement, signed by withdrawing and new partners

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YEAR 1 – BACK TO THE FUTURE

- **Determine goals at the outset**
  - Financing can extend the restriction period
  - How long will rent subsidies last?
  - Ability to pay ballooning debt
  - Extent and durability of improvements
  - Clarify transfer provisions in pertinent documents
  - Review impact of state agencies scoring criteria
- **Structure and review projections**
- **Consider exit tax**
  - Slower depreciation elected or required
  - Source of funds for exit tax

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Exit of Limited Partner: Alternative Strategies

1. Non Profit ROFR w/o Equity
2. Non Profit ROFR w/ Equity
3. For Profit Buyout Option

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STUDY#1:Non-Profit ROFR with No Equity

PROJECT OVERVIEW

- 54 units
- Located in suburbs of Baltimore, MD.
- Serving seniors 62 and over
- 30%, 50% and 60% AMI
- PIS 4/30/2002
- LIHTC compliance period expired 2016
- Extended Use Restrictions expire 2041

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STUDY#1:Non-Profit ROFR with No Equity

STAKEHOLDERS

- General Partner – Established Non Profit
- Limited Partner – Single Investor Fund
- Syndicator – Enterprise
- Lenders:

  1st Federal Home Loan Bank,

  Susquehanna Bank

  2nd Maryland DHCD
- State Allocating Agency – Maryland DHCD
- Residents

STUDY#1:Non-Profit ROFR with No Equity

NEGOTIATION POINTS

- GP holds the Right of First Refusal to purchase property for debt + exit taxes. LP potentially would receive $111,857.

- GP offers to assume limited partners interest citing limitation on value:

  - Large DHCD surplus cash loan

  - The project cannot be recapitalized - Due to age restriction the project is not eligible for 9% credits and is too small for 4% execution

  - The project cannot be refinanced - The first loan currently has a prepayment penalty of $80,000 (which reduces to $0 in 2020)

  - Capital Needs - $700,000
    $200,000 short term (includes roof $100,000)
    $500,000 10 yr.

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STUDY#1:Non-Profit ROFR with No Equity

PARTNERSHIP ECONOMICS

Property NOI	$144,731
Cap Rate	6.8%
Property Value	**$2,128,397**
Plus	
Operating Reserves	$77,037
Replacement Reserves	$109,554
T&I Escrows	$15,794
Cash in Bank	$59,777
	$262,162
Less	
AP/Current Accruals	$6,575
Fees Payable	$6,872
Debt	$2,956,748
	$2,970,195
Net Assets	**$(579,636)**

STUDY#1:Non-Profit ROFR with No Equity

ROFR CALCULATION

Property Sale (debt + taxes)	**$2,956,748**
Less: Wind-up Costs	25,000
Less: Debt	2,956,748
Equals Sale Proceeds	**$(25,000)**
Plus Cash & Reserves	262,162
Less: AP/Accruals/Fees	13,447
Total Proceeds*:	**$223,715**

**Per liquidation provision, proceeds shall be distributed in accordance with capital accounts.*

STUDY#1:Non-Profit ROFR with No Equity

PER LIQUIDATION PROVISIONS

TAX CAPITAL ACCOUNTS:

Total Account Balance = $223,715

GP $111,857.50 (50%)

LP $111,857.50 (50%)

Total Proceeds:	**$223,715**
GP's share (50%)	$111,857.50
LP's share (50%)	$111,857.50

STUDY#1:Non-Profit ROFR with No Equity

FINANCIAL SUMMARY				
PROJECT ECONOMICS				
Property Value	$2,128,397			
Projected Debt	$2,956,748			
Other Liabilities	$13,447			
Cash & Reserves	$262,162			
Capital Account Balances			**Residual Splits (LPA)**	
GP	$111,857.50	50%	80%	
LP	$111,857.50	50%	20%	
Total	$223,715	100%	100%	
VALUATION SUMMARY				
SCENARIO	Property Value	Assets (sale proceeds + net assets)	LP Proceeds per Residual Split	LP Proceeds per Capital Accounts
Sale of Property/Dissolution	$ 2,128,397	$ (579,636)	-	$ -
Buyout Option	$ 2,128,397	$ (579,636)	-	$ -
ROFR Dissolution	$ 2,956,748	$ 223,715		$ 111,857.50
Negotiated Sale Amount	**Debt**			

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STUDY#1:Non-Profit ROFR with No Equity

VIEW FROM THE FUND

- Business Purpose: includes long term preservation after fund exit
- Investor benefits delivered
- Fund IRR exceeds target
- Partnership Agreement provides ROFR disposition in Y16
- **Assign limited partner interest to GP for debt**
- GP assumes all assets and liabilities

STUDY#2:Non-Profit ROFR with Equity

PROJECT OVERVIEW

- 221 units
- Serving seniors 60 and over or disabled
- 30%, 50% and 60% AMI
- PIS 9/15/2003
- LIHTC compliance period expired 2017
- Extended Use Restrictions expire 2048

This is an active, current negotiation.

STUDY#2:Non-Profit ROFR with Equity

NEGOTIATION POINTS

- Project has significant equity in the real estate.
- GP has a ROFR to purchase property for debt plus taxes.
- Agency/lender restrictions will not allow project funds to be used to buyout limited partner.
- Agency debt (2nd position) of $3.6MM is at 1%. All restrictions remain in place until this is paid off; however not before the year 2034.
- Additional regulatory agreements include allocating agency and NYC.
- Long-term preservation owner with no economic or mission incentive to pay off mortgage to exit the LP

STUDY#2:Non-Profit ROFR with Equity

PARTNERSHIP ECONOMICS

Property NOI	$757,329
Cap Rate	6.0%
Property Value	**$12,622,156**
Plus	
Cash and Reserves	$1,833,431
Less	
AP/Current Accruals	$ 349,661
Debt	$8,825,028
Net Assets	**$5,280,898**

Important points to note:

- *Large cash and reserve balance*
- *Significant equity in real estate ($3,797,128)*

STUDY#2:Non-Profit ROFR with Equity

ROFR CALCULATION

Property Sale (debt + taxes)	**$8,825,028**
Less: Wind-up Costs	25,000
Less: Debt	8,825,028
Equals Sale Proceeds	**$(25,000)**
Plus Cash/Reserves	1,833,431
Less: AP/Accruals/Fees	349,661
Total Proceeds*:	**$1,458,770**

**Per liquidation provision, proceeds shall be distributed in accordance with capital accounts. In this case the GP has essentially a $0 capital account – entire amount would go to LP.*

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STUDY#2:Non-Profit ROFR with Equity

Impact of Lender Restrictions & Regulations on LP value

- Public purpose lender – mission to preserve affordable housing. Associated regulatory agreement does not allow partnership resources to be used to buyout a limited partner. Restriction expire upon the later of repayment of debt or the year 2034.
- Due to favorable below-market financing (1%), GP has no economic incentive to refinance.
- Extended land use agreement restricts rent through the year 2048 – partnership will need resources for capital needs.

STUDY#2:Non-Profit ROFR with Equity

ROFR CALCULATION

Property Sale (debt + taxes)	**$8,825,028**
Less: Closing Costs	25,000
Less: Debt	8,825,028
Equals Sale Proceeds	**$(25,000)**
Plus Cash/Reserves	1,833,431
Less: AP/Accruals/Fees	349,661
Total Proceeds	**$1,458,770**
Lender Restrictions	**(1,458,770)**
Distributable Proceeds:	**$0**

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STUDY #3: For Profit with Buyout Option

PROJECT OVERVIEW

- 74 units
- Serving seniors 62 and over
- 30% AMI
- PIS 10/14/2002
- LIHTC compliance period expired 2016
- Extended Use Restrictions expire 2031

STUDY #3: For Profit with Buyout Option

NEGOTIATION POINTS

- GP has a Buyout Option to purchase limited partner interest; chose not to exercise.
- GP stepped into the deal in 2012, at the time it was a troubled asset. As inducement to GP, capital proceeds split changed from 10/90 to 90/10 in favor of GP.
- GP improved operations, turned the project into a performing asset – created value.
- GP is a for-profit developer in the business of providing affordable housing.
- GP made an offer of $300K to acquire LP interest after consideration of buyout price, liquidation value, FMV, history of the project and business purpose of the fund. The final negotiated sale price of the LP interest was $500,000.

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STUDY #3: For Profit with Buyout Option

PARTNERSHIP ECONOMICS

Property NOI	$201,980
Cap Rate	6.0%
Property Value (rounded)	**$3,370,000**
Plus	
Operating Reserves	$76,254
Replacement Reserves	$183,208
T&I Escrows	$32,739
Cash in Bank	$79,537
	$371,738
Less	
AP/Current Accruals	$17,128
Fees Payable	$8,658
Debt	$1,036,710
	$1,062,496
Net Partnership Assets	**$2,679,242**

STUDY #3: For Profit with Buyout Option

BUYOUT PRICE:	
Property	**$3,370,000**
Less: Closing Costs	218,500
Less: Debt	1,036,710
Equals Sale Proceeds	**$2,114,790**
Plus Net Cash & Reserves	345,952
Total Proceeds*:	**$2,460,742**

**Per liquidation provision, proceeds shall be distributed in accordance with capital accounts.*

STUDY #3: For Profit with Buyout Option

BUYOUT PRICE PER LIQUIDATION PROVISION

TAX CAPITAL ACCOUNTS:

Total Account Balance = $2,460,742

GP $100 (.00004%)

LP $2,460,642 (99.99996%)

Total Liquidation Proceeds:	**$2,460,742**
GP's share (.00004%)	$100
LP's share (99.99996%)	$2,460,642

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STUDY #3: For Profit with Buyout Option

FMV OF LP INTEREST

Residual Splits per Partnership Agreement*

GP 90%

LP 10%

Net Partnership Assets	**$2,679,242**
LP Portion (10%)	**$267,924**
Discounted for lack of Control (25%)	**$200,943**
Discounted for Marketability (25%)	**$150,707**

Fair Market Value of LP interest = $150,707

****Residual splits drive fair market valuation***

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STUDY #3: For Profit with Buyout Option

FINANCIAL SUMMARY					
PROJECT ECONOMICS					
Property Value	$3,370,000				
Projected Debt	$1,036,710				
Other Liabilities	$25,786				
Cash & Reserves	$371,738				
Capital Account Balances			**Residual Splits (LPA)**		
GP	$100.00	0.0041%	90%		
LP	$2,460,642	99.996%	10%		
Total	$2,460,742	100%	100%		
VALUATION SUMMARY					
SCENARIO	Property Value	Assets (sale proceeds + net assets)	LP Proceeds per Residual Split	FMV of LP Interest	LP Proceeds per Capital Accounts
Sale of Property/Dissolution	$ 3,370,000	$ 2,679,242	-	-	$ 2,460,742
Buyout Option	$ 3,370,000	$ 2,679,242	-	-	$ 2,460,742
ROFR Dissolution	-	-	-	-	-
Fair Market Valuation	$ 3,370,000	$ 2,679,242	$ 267,924	$ 150,707	-
Negotiated Sale Amount	**$ 500,000**				

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STUDY #3: For Profit with Buyout Option

VIEW FROM THE FUND

- Business Purpose: includes long term preservation after fund exit
- Investor benefits delivered
- Fund IRR exceeds target
- Captured residual value
- Acknowledged GP contribution to operations, stepping into trouble asset
- **Assign limited partner interest to GP for $500,000**
- GP assumes all assets and liabilities

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SOME TAKEAWAYS

- Capital account balances may skew distributions to limited partner.
- Capital proceeds split drive refinance distributions and typically fair market valuation of limited partner interest.
- Exits may be delayed by agency/lender consent process.
- Lender/agency restrictions on cash and reserves may impact LP value.
- Extended-use period drives need for properties to be well capitalized.
- Majority of transfers are to current GP and involve simple transfer of limited partner interest.

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QUESTIONS AND ANSWERS

Q&A

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For further information, go to the www.enterprisecommunity.com website, and look for Year 15 information under Asset Management.

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