Year 15: Transition Strategies for Expiring LIHTC Properties

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Presenters:
Sean Barnes, Sr. Disposition Manager, Asset Management
Laura Turner, Sr. Disposition Manager, Asset Management
Candida Felix, Director, Tax and Regional Accounting
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
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
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
THE STAKEHOLDERS

- Residents
- General Partners/Sponsors/Developers
- Investors
- Syndicators
- Private Lenders
- Public Lenders
- Allocating Agencies
- The IRS
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
Types of Investors 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)
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
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
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
Typically, option price is greater of:

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

Or

- Unpaid Benefits plus Exit Taxes
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
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
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)
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?
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 handled?
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
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
YEARS 14-15:

- Consult with Accountant and Attorney
- Meet with Syndicator
- Negotiate Purchase Price
- Sign Letter of Intent
- Obtain Lender Approvals
- Draft Legal Agreements
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
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
Exit of Limited Partner: Alternative Strategies

1. Non Profit ROFR w/o Equity
2. Non Profit ROFR w/ Equity
3. For Profit Buyout Option
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
STUDY#1: Non-Profit ROFR with No Equity

STAKEHOLDERS

- General Partner – Established Non Profit
- Limited Partner – Single Investor Fund
- Syndicator – Enterprise
- Lenders:
  1\textsuperscript{st} Federal Home Loan Bank,
  Susquehanna Bank
  2\textsuperscript{nd} Maryland DHCD
- State Allocating Agency – Maryland DHCD
- Residents
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.
<table>
<thead>
<tr>
<th>PARTNERSHIP ECONOMICS</th>
<th></th>
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<tbody>
<tr>
<td>Property NOI</td>
<td>$144,731</td>
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<tr>
<td>Cap Rate</td>
<td>6.8%</td>
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<tr>
<td>Property Value</td>
<td>$2,128,397</td>
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<td>Plus</td>
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<td>Operating Reserves</td>
<td>$77,037</td>
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<td>Replacement Reserves</td>
<td>$109,554</td>
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<td>T&amp;I Escrows</td>
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<td>$262,162</td>
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<td>AP/Current Accruals</td>
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<td>$2,970,195</td>
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<tr>
<td>Net Assets</td>
<td>$(579,636)</td>
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</tbody>
</table>
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.
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

### PROJECT ECONOMICS

<table>
<thead>
<tr>
<th>Property Value</th>
<th>$2,128,397</th>
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<tbody>
<tr>
<td>Projected Debt</td>
<td>$2,956,748</td>
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<tr>
<td>Other Liabilities</td>
<td>$13,447</td>
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<tr>
<td>Cash &amp; Reserves</td>
<td>$262,162</td>
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### Capital Account Balances

<table>
<thead>
<tr>
<th>Capital Accounts</th>
<th>GP</th>
<th>LP</th>
<th>Total</th>
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<tbody>
<tr>
<td>Residual Splits</td>
<td>$111,857.50</td>
<td>$111,857.50</td>
<td>$223,715</td>
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<tr>
<td>LPA</td>
<td>50%</td>
<td>50%</td>
<td>100%</td>
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### SCENARIO

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Property Value</th>
<th>Assets (sale proceeds + net assets)</th>
<th>LP Proceeds per Residual Split</th>
<th>LP Proceeds per Capital Accounts</th>
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<tbody>
<tr>
<td>Sale of Property/Dissolution</td>
<td>$2,128,397</td>
<td>$579,636</td>
<td>$</td>
<td>$</td>
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<tr>
<td>Buyout Option</td>
<td>$2,128,397</td>
<td>$579,636</td>
<td>$</td>
<td>$</td>
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<tr>
<td>ROFR Dissolution</td>
<td>$2,956,748</td>
<td>$223,715</td>
<td>$111,857.50</td>
<td></td>
</tr>
</tbody>
</table>

### VALUATION SUMMARY

**FINANCIAL SUMMARY**

**CASH ACCOUNTS**

| Cash & Reserves | $262,162 |

**DEBT ACCOUNTS**

| Projected Debt | $2,956,748 |

**EQUITY ACCOUNTS**

| Other Liabilities | $13,447 |

**OTHER ACCOUNTS**

| Projected Equity | $1,004,751 |

**DEVELOPMENT COSTS**

| Development Costs | $4,000,000 |

**DEVELOPMENT ACCOUNTS**

| Development Receipts | $5,000,000 |

| Development Costs | $4,000,000 |

**DEVELOPMENT MARGINS**

| Development Margin | $1,000,000 |

**DEVELOPMENT PROFITS**

| Development Profits | $1,000,000 |

**TOTAL EQUITY ACCOUNTS**

| Total Equity Accounts | $1,014,215 |

**TOTAL DEBT ACCOUNTS**

| Total Debt Accounts | $2,956,748 |

**TOTAL OTHER ACCOUNTS**

| Total Other Accounts | $13,447 |

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| Total Other Accounts | $13,447 |
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
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.*
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 (2\(^{nd}\) 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

<table>
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<tr>
<th>Description</th>
<th>Value</th>
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<tr>
<td>Property NOI</td>
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<td>Cap Rate</td>
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<tr>
<td>Property Value</td>
<td>$12,622,156</td>
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<tr>
<td>Plus Cash and Reserves</td>
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<tr>
<td>Less AP/Current Accruals</td>
<td>$349,661</td>
</tr>
<tr>
<td>Debt</td>
<td>$8,825,028</td>
</tr>
<tr>
<td><strong>Net Assets</strong></td>
<td><strong>$5,280,898</strong></td>
</tr>
</tbody>
</table>

**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.*
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**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property Sale (debt + taxes)</td>
<td>$8,825,028</td>
</tr>
<tr>
<td>Less: Closing Costs</td>
<td>25,000</td>
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<tr>
<td>Less: Debt</td>
<td>8,825,028</td>
</tr>
<tr>
<td>Equals Sale Proceeds</td>
<td>$(25,000)</td>
</tr>
<tr>
<td>Plus Cash/Reserves</td>
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<tr>
<td>Less: AP/Accruals/Fees</td>
<td>349,661</td>
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<tr>
<td><strong>Total Proceeds</strong></td>
<td>$1,458,770</td>
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<tr>
<td>Lender Restrictions</td>
<td>(1,458,770)</td>
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<tr>
<td>Distributable Proceeds</td>
<td>$0</td>
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</table>
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.
### STUDY #3: For Profit with Buyout Option

**PARTNERSHIP ECONOMICS**

<table>
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<th>Description</th>
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<td>Property NOI</td>
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<td>Cap Rate</td>
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<td>Property Value (rounded)</td>
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<tr>
<td>Plus</td>
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<td>Operating Reserves</td>
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<td>Replacement Reserves</td>
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<td>T&amp;I Escrows</td>
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<td><strong>Total Plus</strong></td>
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<td>AP/Current Accruals</td>
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<td>Fees Payable</td>
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<td>Debt</td>
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<td><strong>Total Less</strong></td>
<td><strong>$1,062,496</strong></td>
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<tr>
<td><strong>Net Partnership Assets</strong></td>
<td><strong>$2,679,242</strong></td>
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</table>
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
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
### STUDY #3: For Profit with Buyout Option

#### PROJECT ECONOMICS
- Property Value: $3,370,000
- Projected Debt: $1,036,710
- Other Liabilities: $25,786
- Cash & Reserves: $371,738

#### Capital Account Balances

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<thead>
<tr>
<th>Residual Splits (LPA)</th>
<th>GP</th>
<th>LP</th>
<th>Total</th>
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<td></td>
<td>$100.00</td>
<td>$2,460,642</td>
<td>$2,460,742</td>
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<tr>
<td></td>
<td>0.0041%</td>
<td>99.996%</td>
<td>100%</td>
</tr>
<tr>
<td></td>
<td>90%</td>
<td>10%</td>
<td>100%</td>
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</table>

### FINANCIAL SUMMARY

#### SCENARIO

- **Sale of Property/Dissolution**
  - Property Value: $3,370,000
  - Assets (sale proceeds + net assets): $2,679,242
- **Buyout Option**
  - Property Value: $3,370,000
  - Assets (sale proceeds + net assets): $2,679,242
- **ROFR Dissolution**
  - Property Value: -
  - Assets (sale proceeds + net assets): -
- **Fair Market Valuation**
  - Property Value: $3,370,000
  - Assets (sale proceeds + net assets): $2,679,242
  - Fair Market Valuation: $267,924
  - LP Proceeds per Capital Accounts: $150,707

#### Negotiated Sale Amount
- $500,000
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
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.
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.