Year 15: Transition Strategies for Expiring LIHTC Properties

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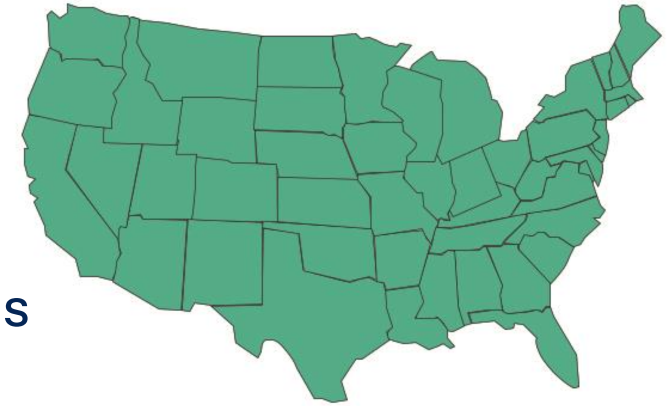
Objective of This Training

- Understand Background on Year 15
- Discuss Key Exit Options, Including ROFR & Buyout Options
- Understand Perspectives of Stakeholders
- Re-syndication
- Capital Accounts & Exit Taxes
- Learn how to Develop an Action Plan
- Review Case Studies

National LIHTC Stock

Over 3 Million Units



- Urban, Suburban & 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 1,560

Projects Transferred

Projecting in Excess of

100/YEAR

Over the Next

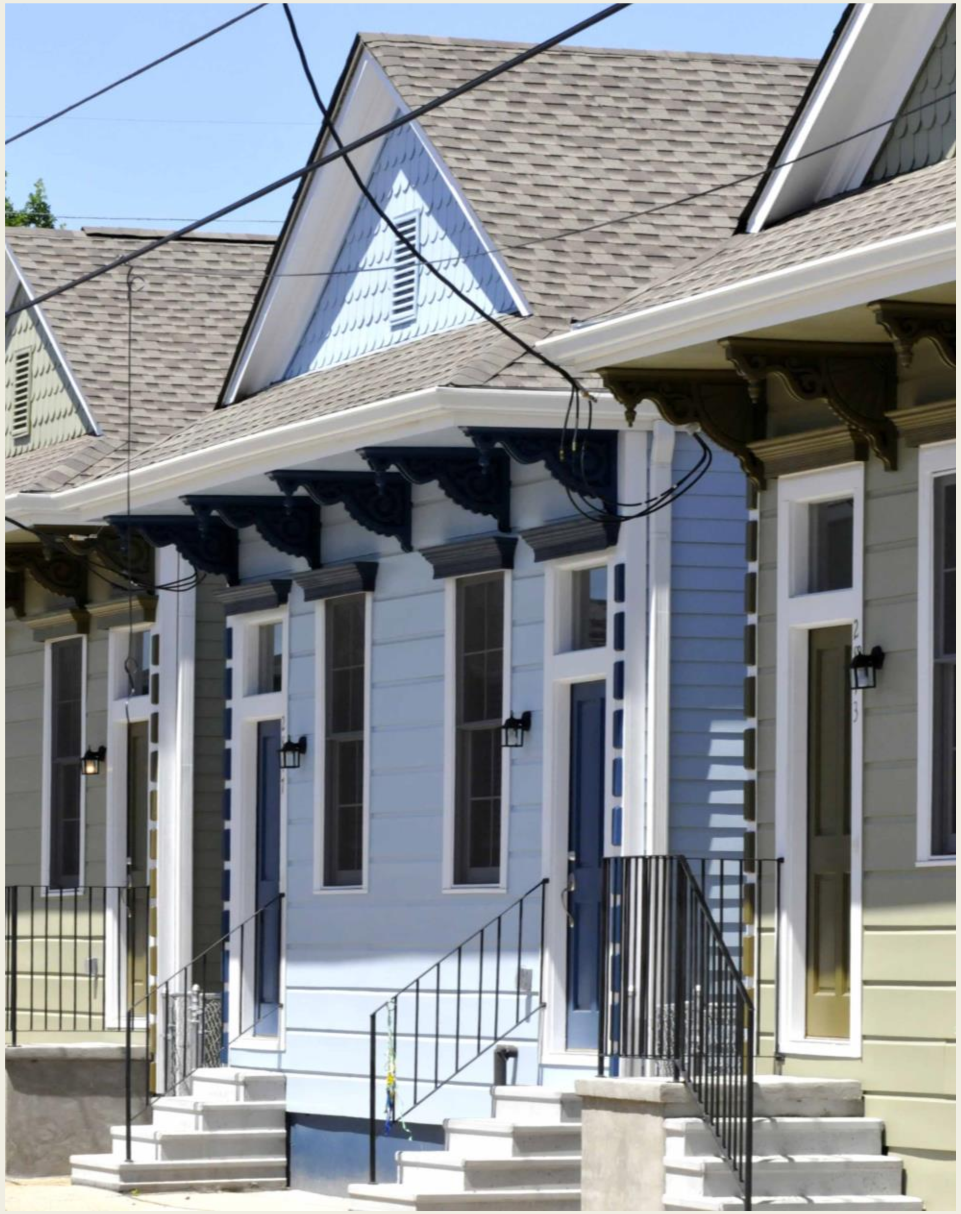
5 YEARS

The Year 15 "Mantra"

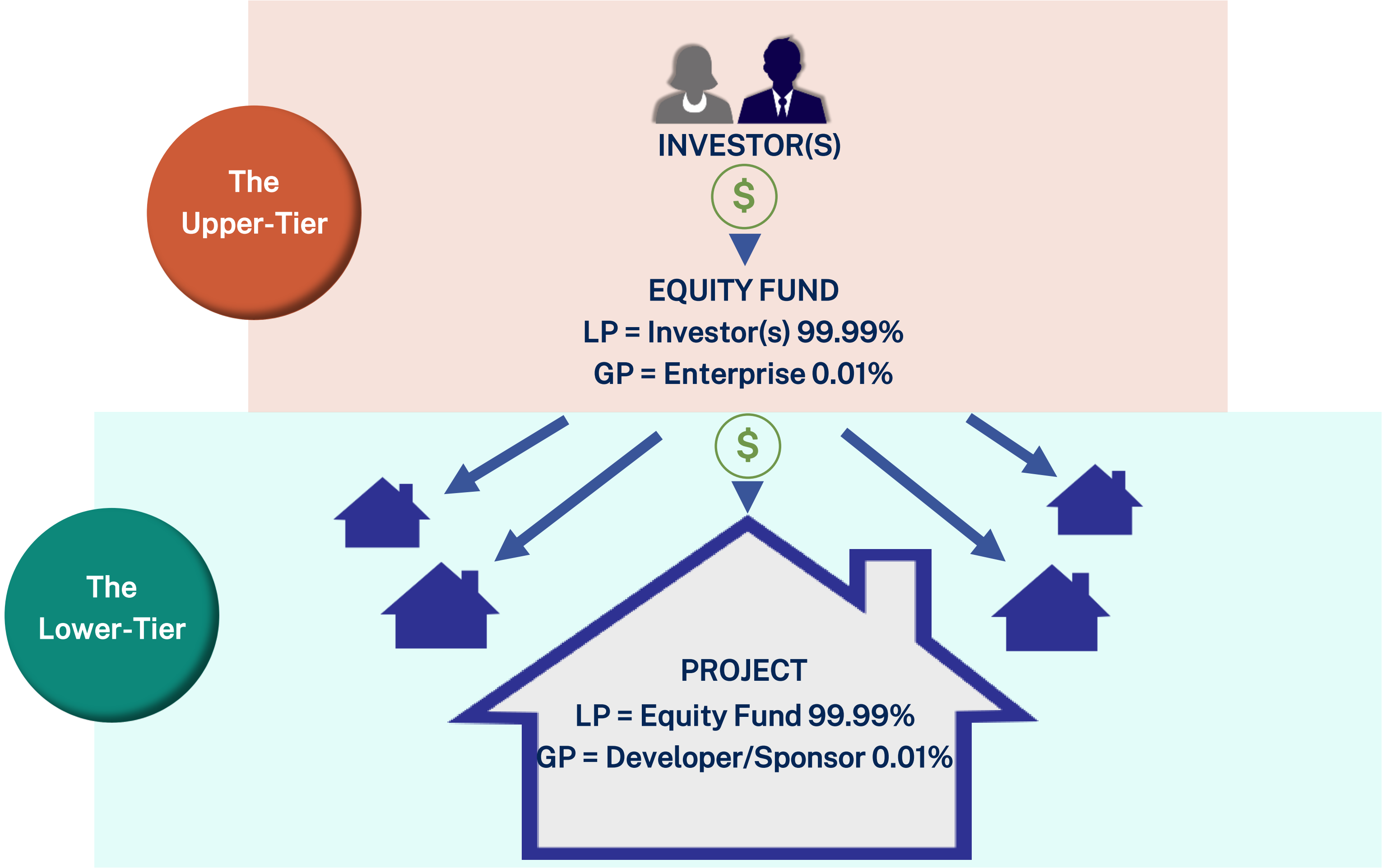
- **Step 1** — Know The Property
- **Step 2** — Know Your Partners & Stakeholders
- **Step 3** — Know Your Documents
- **Step 4** — Develop Your Plan

The Stakeholders

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



Overview of Tax Credit Investing



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

Type 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)

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 & viability
- Avoid displacement of low-income residents
- Can provide equity to re-syndicate the project with new tax credits
- Can provide debt to refinance the project

Significance of Year 15

Initial Compliance Period Expires at the End of Year 15

- Can transfer ownership in year 16 without recapture
- Tax credit transactions are envisioned by investors as 15-year investments
- Most investors are ready to dispose of their interest in year 16

Determining Year 15

Tax Credit Compliance Ends:

- The last day of the 15th year since credits were first taken
- May be different for different buildings
- Plan disposition in Year 16 for the last building placed in service

Determining Year 15

Example:

- Tax Credits allocated in 2008
- Building Placed in Service (PIS) in 2009
- Elected to begin taking credits in 2010
- Tax Credit Compliance Period expires 12/31/24
- Year 15 is 2024; Year 16 is 2025

Exit Strategies: Possible Scenarios

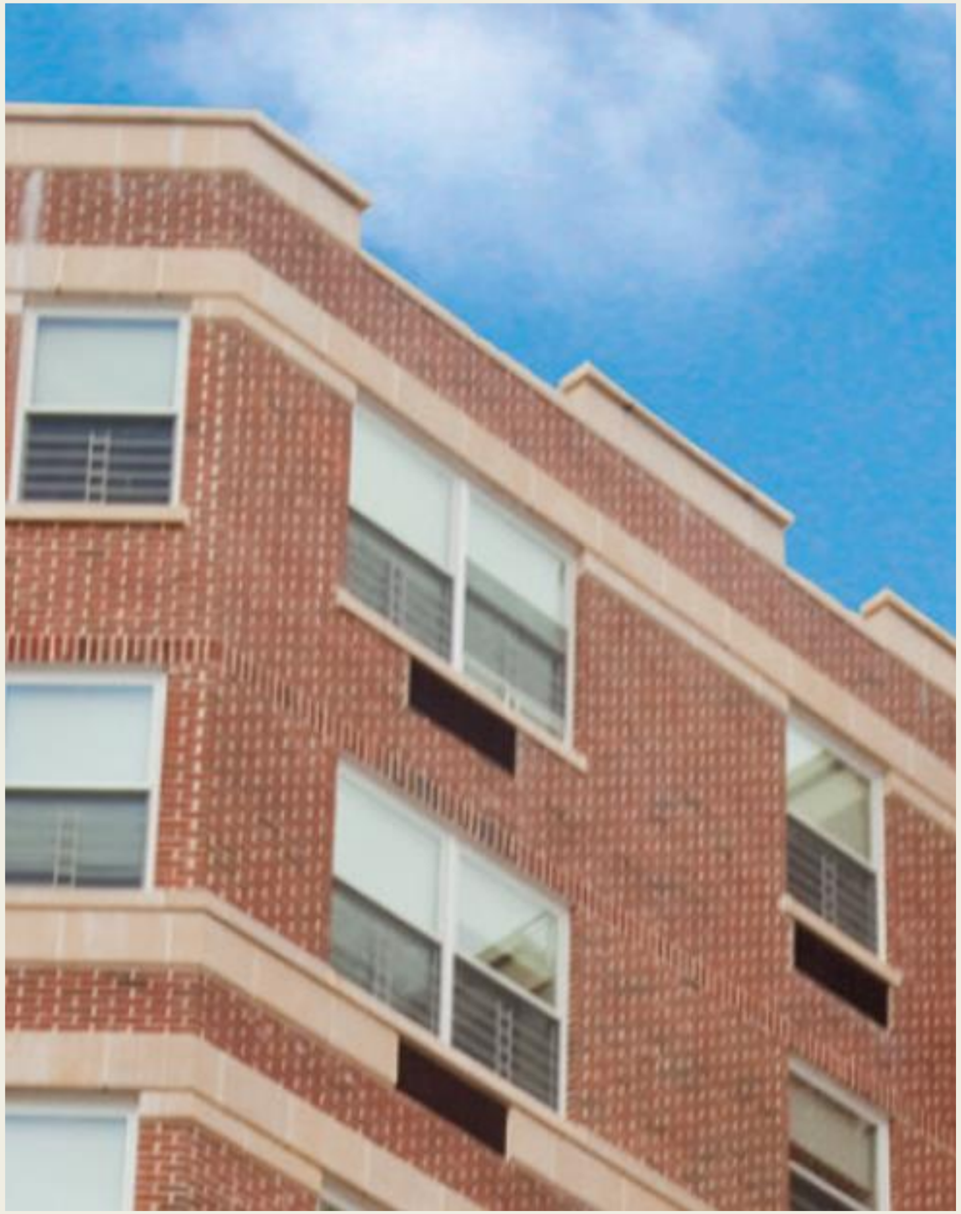
- Right of First Refusal to purchase property
- Buyout option to purchase investor interest
- Purchase within compliance period (“Early Exit”)
- “Puts”: Obligation for GP to Purchase Investor Interest
- Sale to 3rd party

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



Buyout Option of Investor Interest

Typically, Option Price is GREATER OF:

Fair Market Value of Investor Interest
as determined by an appraisal of limited partnership interest

Or

$10 + all federal, state, and local taxes attributable to the investor interest sale, including investor exit taxes

* Terms of buyout option may depend on investor and upon vintage of the agreement

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

CAPITAL ACCOUNTS & EXIT TAXES

Investor Capital Account

Balance is comprised of:

- Capital Contributions
- *Less*: Distributions
- *Less*: Taxable Losses
- *Less*: Historic Credits (If Applicable)
- *Less*: Syndication Cost

Investor Capital Account cannot be negative unless Minimum Gain exists:

- Nonrecourse Debt
- *Less* Net Book Value of Assets

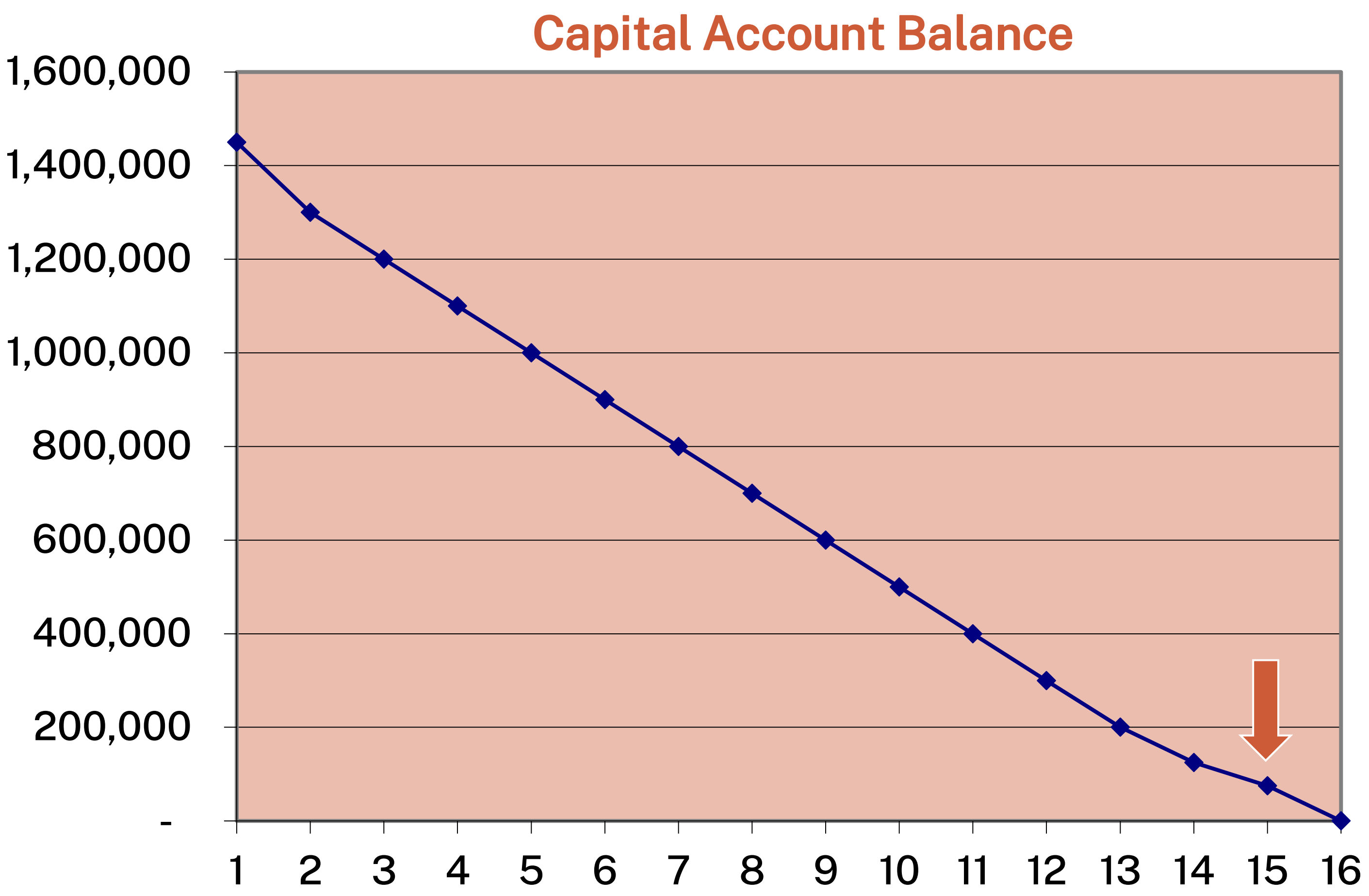
Tax basis, not GAAP

Investor Capital Account (Cont'd)

- Must zero out upon investor exit
- 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

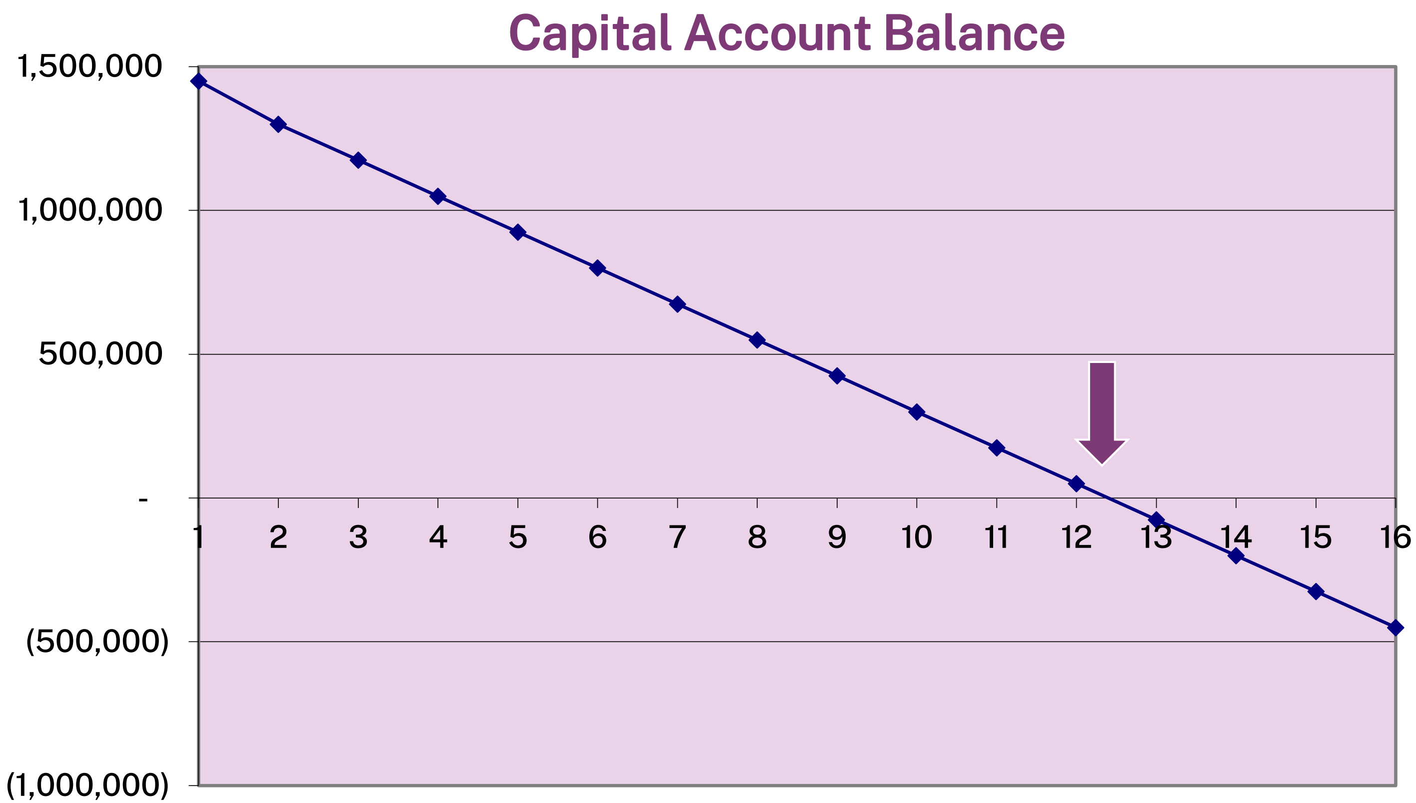
Capital Account: Example #1

Remains Positive Through Compliance Period – An Expense/Deduction Will be Taken by the LP



Capital Account: Example #2

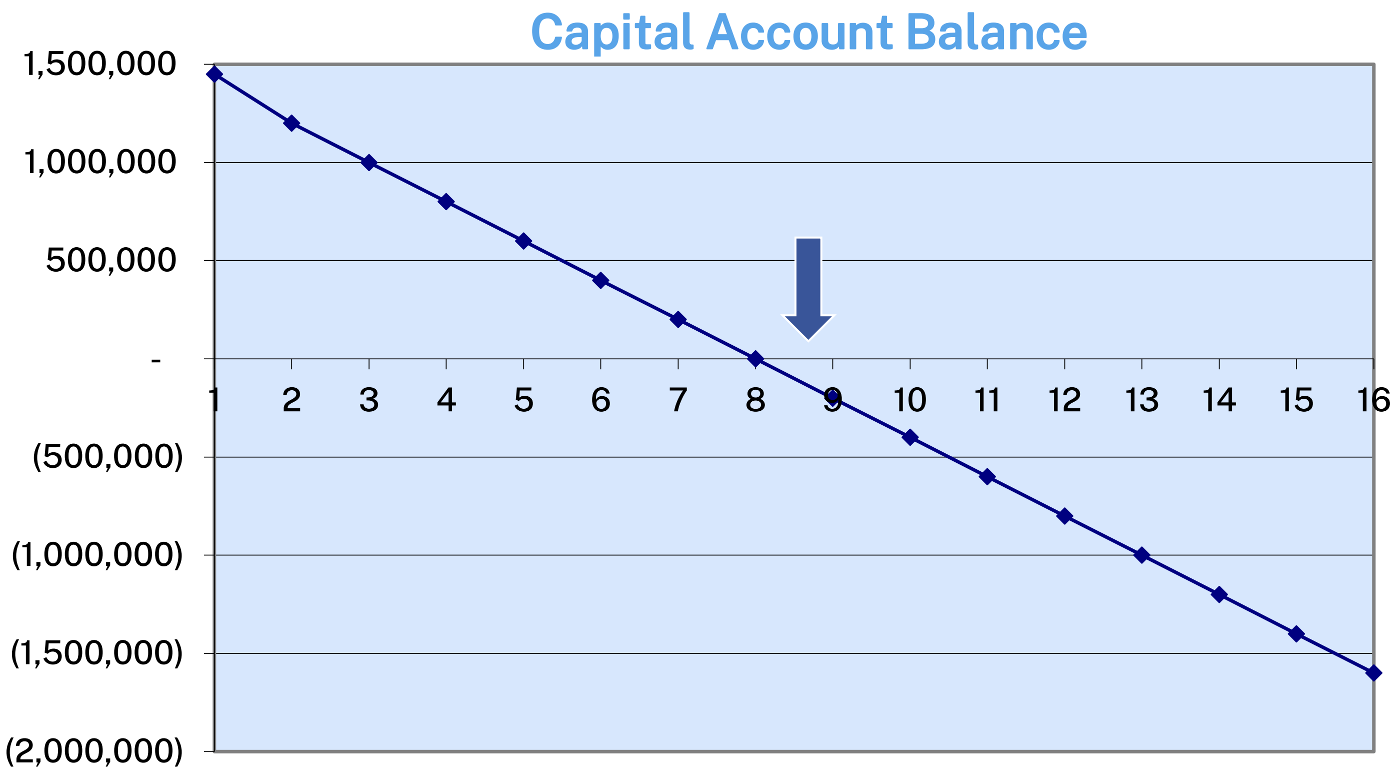
Goes Negative After The End of The Credit Period; Before The End of The Compliance Period



Losses may or may not be taken by the LP

Capital Account: Example #3

Goes Negative Before The End of The Credit Period



Credits follow depreciation, if the LP cannot take the losses, they may lose the credits

Exit Tax Calculation Example, with Gross Up

"Sales Price = Debt + Exit Taxes"...what are the exit taxes?

LP has a capital account balance of ($500,000)

Exit tax = $500,000 x 21% (federal rate) = $105,000

The payment of the exit taxes by the GP creates another taxable event

$105,000 x 21% = $22,050

Total exit taxes $105,000 + $22,050 = $127,050

-or-

Apply "gross up" factor: 1 + tax rate ($105,000 X 1.21 = $127,050)

Ways to Manage Exit Taxes

From Years 11-15:

- Forgive debt
- Reduce LP interest
- Relate qualified non-recourse debt and/or add security to debt
- Capitalize rather than expense repairs
- Improve operations

GP ACTION PLAN – WHAT TO DO STARTING IN YEAR 10?

Action Plan For Purchasers: Year 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?

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?

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?

Action Plan For Purchasers: Year 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

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

Action Plan For Purchasers: Year 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 assignment agreement
- 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

Case Studies

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

Study#1: Non-Profit ROFR without Equity

Case Study #1

PROJECT OVERVIEW

- 76 units (33 Non-LIHTC)
- Nebraska property
- Serving families
- 60% AMI
- PIS 09/30/2008
- LIHTC compliance period expired 2023
- Extended Use Restrictions expire 2038

Study #1: Non-Profit ROFR without Equity

Case Study #1

STAKEHOLDERS

- General Partner – Municipality Affiliated Entity (Non-Profit)
- Limited Partner – Multi-Investor Fund
- Syndicator – Enterprise
- Lenders -Conventional & Public Purpose Debt
- State Allocating Agency
- Residents

NEGOTIATION POINTS

- GP holds the Right of First Refusal to purchase property for debt + taxes
- Positive Capital Account - No Exit Taxes Due
- GP also has Buyout Option to purchase LP interest
- Accrued debt exceeds estimated property value
- $5.3MM in related party debt (2nd & soft loans)
- Significant capital needs

Study #1: Partnership Economics

Case Study #1

Property (Net) NOI	$200,975
Cap Rate	6.05%
Property Value (NOI/Cap Rate)	**$3,321,900**
Plus	
Operating Reserves	$204,745
Replacement Reserves	$356,352
T&I Escrows	$59,528
Cash in Bank	$128,242
	$748,867
Less	
AP/Current Accruals	$ 105,362
Debt	$6,561,351
	$6,666,713
= Net Partnership Assets	**$(2,595,946)**

→ real estate valued at less than ROFR price of debt + taxes

Study #1: Non-Profit ROFR without Equity

Case Study #1

VIEW FROM THE FUND

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

Due to the lack of any value in excess of debt, a sale of the investor interest in this partnership for no monetary consideration would be appropriate for a nonprofit or a for profit partner.

Study#2: Non-Profit ROFR with Equity

PROJECT OVERVIEW

- 56 units
- Serving Seniors
- 50% and 60% AMI
- PIS 2007
- LIHTC compliance period expired 2022
- Extended Use Restrictions expire 2037

Case Study #2

Study #2: Non-Profit ROFR with Equity

Case Study #2

NEGOTIATION POINTS

- Project has equity in the real estate.
- GP has a ROFR to purchase property for debt plus taxes, resulting in partnership dissolution and distribution of remaining balance sheet items.
- LPA allows for replacement reserves to be spent in preparation of a sale
- Project has significant annual cashflow

Study #2: Partnership Economics

Case Study #2

Property NOI (Less Reserves)	$219,155
Cap Rate	6.05%
Property Value	**$3,622,397**
Plus	
Cash	$ 161,633
Operating Reserves	$ 63,002
Replacement Reserves	$ 77,475
TOTAL =	$302,110
Less	
AP/Current Accruals	$ 176,664
Debt	$2,776,947
= Net Partnership Assets	**$ 970,896**

→ **real estate greater than ROFR price of debt + taxes**

Study #2: Non-Profit ROFR with Equity

Case Study #2

Property Sale	
Debt	**$2,776,947**
Taxes	0
Less: Debt	2,776,947
= Sale Proceeds from Property	(0)
Plus: Cash & Reserves available for distr.	224,635
Less: AP/Accruals/Fees	176,664
Less: Wind-up costs	25,000
= Net Assets Available for Distribution	**$22,971** *

→ vs. property valued at $3.6mm

Real estate equity of $845,450 goes to nonprofit per IRC section 42 ROFR

* In this scenario, precise ROFR calculation resulted in distribution of $22,971 to the investor.

Study #2: Non-Profit ROFR with Equity

Case Study #2

Highlights of Transaction

- Depending on investor expectations, sales price may be negotiated in the range of $0 - $22,971
- ROFR allows GP to retain equity in property
- LPA allows replacement reserves to stay with property
- Structured as transfer of LP interest to the benefit of all parties (reduced costs, example)
- Extended land use agreement restricts rent through the year 2036 – partnership will need resources for capital needs.

Study #2: Non-Profit ROFR with Equity

Case Study #2

VIEW FROM THE FUND

- Fund Goal: includes long term preservation after investor exit. Nonprofit owner will retain at least $970,896 in value in excess of debt.
- Projected lower tier benefits delivered
- Fund IRR exceeds target
- Partnership Agreement provides ROFR disposition in Y16
- Collect up to $22,971 in proceeds.

Study#3: For Profit Buy Out Option

Case Study #3

HYPOTHETICAL SCENARIO

- Assume prior Case Study #2 has a for profit developer with only a buyout option allowing acquisition of limited partner's 99.99% ownership interest for the greater of:
    - The fair market value of the limited partner's interest, or
    - Investor exit taxes
- "Fair Market Value" may be defined differently depending on the partnership agreement

Study#3: For Profit Buy Out Option

Case Study #3

		AT FULL VALUE:
Property Sales Price	$2,776,947	$ 3,622,397
+ Taxes	0	0
Less: Debt	2,776,947	2,776,947
= Sale Proceeds from Property	(0)	$ 845,450
Plus: Cash & Reserves available for distr.	224,635	302,110
Less: AP/Accruals/Fees	176,664	176,664
Less: Wind-up costs	25,000	25,000
= Net Assets Available for Distribution	**$22,971**	**$945,896 ***

Buyout price to exiting LP is $94,590 **

**** Represents total, net partnership value.***

***** Assuming LP appraisal concludes to LP value equal to 10% of net total partnership assets.***

Some Takeaways

- Majority of transfers are to current GP and involve simple transfer of limited partner interest.
- Year 15 “mantra”
- Exits may be delayed by agency/lender consent process.
- Lender/agency restrictions on cash and reserves may impact value.
- Extended-use period drives need for properties to be well capitalized.

QUESTIONS???

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