What’s Your Game Plan?

Resyndicating Permanent Supportive Housing Projects

Tax Issues and Structuring Details

Kyle Arndt
Bocarsly Emden Cowan Esmail & Arndt LLP
(213) 239-8048
karndt@bocarsly.com

WHY IS THIS SO COMPLICATED AND CONVOLUTED?
2016 Tax Expenditures v. Direct Government Spending

<table>
<thead>
<tr>
<th>Tax Expenditures</th>
<th>Medicare &amp; Medicaid</th>
<th>Social Security</th>
<th>Non-defense discretionary</th>
<th>Defense discretionary</th>
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<tbody>
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<td>$1.2 trillion</td>
<td>$890 billion</td>
<td>$882 billion</td>
<td>$685 billion</td>
<td>$583 billion</td>
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</tbody>
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Fiscal Year 2016 Federal Tax Expenditures (in millions of dollars)

1. Exclusion of employer contributions for medical insurance premiums and medical care $216,080
2. Mortgage interest expense on owner-occupied residences 75,260
3. Capital gains (except agriculture, timber, iron ore, and coal) 93,030
4. Exclusion of net imputed rental income 82,420
5. Defined contribution employer plans 73,910
6. Deferral of income from controlled foreign corporations (normal tax method) 67,780
7. Step-up basis of capital gains at death 66,670
8. Deductibility of nonbusiness State and local taxes other than on owner-occupied homes 51,180
9. Defined benefit employer plans 46,260
10. Deductibility of charitable contributions, other than education and health 47,380
11. Capital gains exclusion on home sales 39,560
12. Exclusion of interest on public purpose State and local bonds 35,190
13. Deduction for property taxes on real property 35,520

27. Credit for low-income housing investments 7,890
Qualifying for the Acquisition Credits

1. The building is acquired by purchase.

2. There is a period of at least 10 years between the date of its acquisition by the taxpayer and the date the building was last placed in service OR the building “is substantially assisted, financed, or operated under section 8 of the United States Housing Act of 1937, section 221(d)(3), 221(d)(4), or 236 of the National Housing Act, section 515 of the Housing Act of 1949, or any other housing program administered by the Department of Housing and Urban Development or by the Rural Housing Service of the Department of Agriculture.”

3. The building was not previously placed in service by the taxpayer or by any person who was a related person with respect to the taxpayer as of the time previously placed in service.

Issues in Determining Acquisition Basis

True Debt Test

• Debt is not “true debt” if it can’t be repaid or refinanced upon maturity

• If Debt is not “true debt” it will be treated as a grant for tax purposes

• 55 year projections are an art, not a science - confirm assumptions

• Problem may be worse with a lease because refinancing may be more difficult
Issues in Determining Acquisition Basis

- The higher the purchase price . . . the higher to basis . . . the greater the credits . . . the greater the equity . . . the happier the developer.

- Value is “as-is” not “as will be”

- Basis is calculated on the Purchase Price of the Building, NOT the Land.

- Allocation of Purchase Price between Building and Land
  - MAI Appraisal
  - Residual Analysis

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Issues in Determining Acquisition Basis

*Acquisition Value – Limitations on Acquisition Price?*

- Third Party Seller, All Cash? – Pay as much as you want

- Related Party Seller – You can only buy for appraised value (notwithstanding TCAC Reg. Section 10322(h)(9)(A))

- Assuming Debt? – Beware overvalue basis reduction (Any Debt Instrument in excess of value may be excluded from acquisition basis)
Issues in Determining Acquisition Basis

Assuming and Recasting Original Debt

• Debt which is assumed but is not modified has no issues, but is rare in a resyndication deal due to need to modify terms

• Debt which is Significantly Modified (i.e. change to term, amount, security, etc.) at an interest rate below AFR is subject to OID Rules

• When OID rules are applied, the face value and tax value of a debt instrument may be different

• OID rules can be used as a tool to manage over value purchase due to assumed debt

Related Party Issues

Related Party Acquisitions

• Acquisition Credits only available if building is purchased from unrelated party

• 50% Capital and Profits Test of Buyer and Seller

• Think ahead before you buy or buy-out
Related Party Issues

*Related Party Debt*

- Many resyndication transactions use Seller Carryback Debt to maximize purchase price
- Seller Carryback Debt must be at AFR or will be subject to OID rules
- Related party debt generally treated as recourse
- 20% Capital and Profits Test of Lender and General Partner

Over Income Tenant & Rent Limit Issues

*Post Acquisition Income Qualification and Rents*

- Grandfathering of Over Income Units Allowed if Encumbered by Extended Use Agreement
- Hold Harmless Rents will reset per Section 42 but TCAC may provide synthetic relief
Extended Use Language
Required to Allow Grandfathering of Overincome Units

Exhibit A of this Agreement, attached hereto and incorporated herein (the "Project"). This Agreement is intended to constitute the extended low income housing commitment required by Section 42(h)(6) of the Internal Revenue Code. Accordingly, in consideration of the allocation relating to the Tax Credit by TCAC and the requirements of the Internal Revenue Code, the Owner and TCAC hereby agree as follows:

REGULATORY AGREEMENT

Federal Credit

The Regulatory Agreement (this "Agreement") is made between the California Tax Credit Allocation Committee ("TCAC"), established under Section 50196.8 of the Health and Safety Code of the State of California, and Horizon Coast Associates, a California Limited Partnership ("Owner") and is dated as of February 18, 2000 (the "Effective Date"). The Owner has qualified and TCAC has evidenced in allocations relating to the low-income housing tax credit (the "Federal Tax Credit") under Section 42 of the Internal Revenue Code of 1986 (collectively, the "Tax Credit"). The Tax Credit relates to the multifamily rental housing project known as Horizon Court, identified by the records of TCAC as TCAC-CA-99-317 and has Building Identification Number CA-99-21795 through CA-99-21803, and located on the real property described in Exhibit A of this Agreement, attached hereto and incorporated herein (the "Project"). This Agreement is intended to constitute the extended low income housing commitment required by Section 42(h)(6) of the Internal Revenue Code. Accordingly, in consideration of the allocation relating to the Tax Credit by TCAC and the requirements of the Internal Revenue Code, the Owner and TCAC hereby agree as follows:

Section 1. Definitions.

1. Unless the context otherwise requires, capitalized terms used in this Agreement shall have the following meanings:

* "Agreement" means this Regulatory Agreement between TCAC and the Owner.

* "Applicable Fraction" means the smaller of the High Fraction or the Floor Space Fraction, all calculated in accordance with Section 42(g)(1) of the Code.

* "Area Median Gross Income" means the median gross income of the area in which the Project is located as determined by the Secretary for purposes of Section 42 of the Code, including adjustments for family size.

* "Assumption Agreement" shall have the meaning assigned in Section 15 hereof.

"Code" means the provisions of the Internal Revenue Code of 1986, as amended, and regulations promulgated pursuant thereto.

Records Requested by and when recorded to:

Mortgage Bank & Tax Credit Allocation Committee
301 E Street
Sacramento, CA 95814-1001

Regulatory Agreement (this "Agreement") is made between the California Tax Credit Allocation Committee ("TCAC"), established under Section 50196.8 of the Health and Safety Code of the State of California, and Horizon Coast Associates, a California Limited Partnership ("Owner") and is dated as of January 1, 1990. The Owner has qualified and TCAC has evidenced in allocations relating to the low-income housing tax credit (the "Federal Tax Credit") under Section 42 of the Internal Revenue Code of 1986 (collectively, the "Tax Credit"). The Tax Credit relates to the multifamily rental housing project known as Horizon Court, identified by the records of TCAC as TCAC-CA-99-317 and has Building Identification Number CA-99-21795 through CA-99-21803, and located on the real property described in Exhibit A of this Agreement, attached hereto and incorporated herein (the "Project"). This Agreement is intended to constitute the extended low income housing commitment required by Section 42(h)(6) of the Internal Revenue Code. Accordingly, in consideration of the allocation relating to the Tax Credit by TCAC and the requirements of the Internal Revenue Code, the Owner and TCAC hereby agree as follows:

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Developer Fee Issues

Calculation of Developer Fee

• The higher the Developer Fee . . . the higher to basis . . . the greater the credits . . . the greater the equity . . . the happier the developer

• Just because TCAC allows it, doesn’t mean it is reasonable

• Developer Fee must be reasonably allocated between Development and Acquisition

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Developer Fee Issues

Repayment of Deferred Developer Fee

• Developer Fee must be repayable within a reasonable period of time

• Catch and Release – Contribution of developer fee to Partnership
TCAC Transfer Event Issues

- All Transfers Events TCAC Consent
- A Transfer Event may trigger the need to obtain a Qualified Capital Need Assessment analyzing the capital needs of the project for three years and reserving therefor
- Because many Transfer Events involving Permanent Supportive Housing don’t result in distribution of Net Project Equity, the CNA requirement is often not applicable

Questions & Answers