Forward Thinking: Year 15 Preparation

Housing Colorado NOW! Annual Conference

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Agenda

What is Year 15?

GP Perspective – Mercy Housing

LP Perspective – PNC Bank

Sale of Property

Sale of Property Example

Exit of Limited Partner

Resyndication

Qualified Contract

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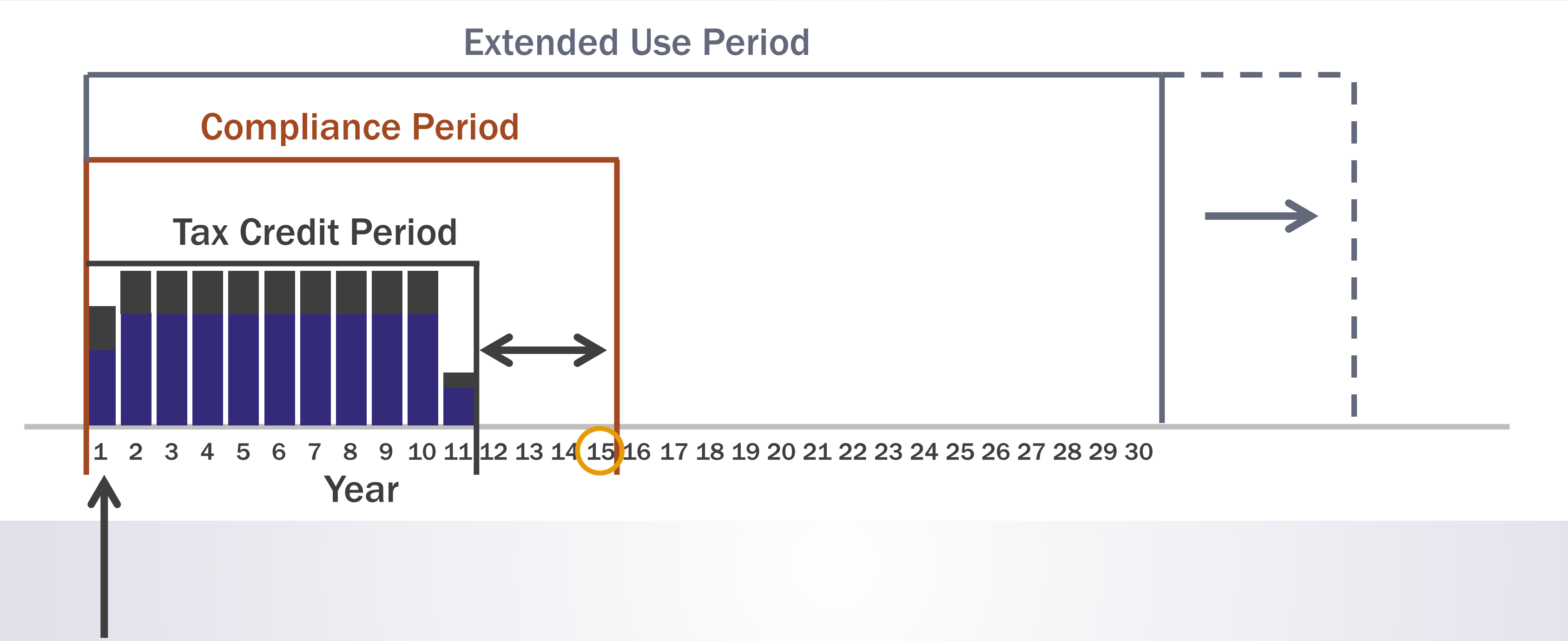

Tax Credit Period:
Begins on first day of taxable year in which owner claims credits

Options

Sale of property

Exit of limited partner

Once limited partner is out, can:

Resyndicate

Qualified Contract

Preparing to Negotiate with your Limited Partner

- What is your objective as the GP?
- Who is your LP?
  - Same as original LP?
  - Direct investor?
  - LP contact has most likely changed over the years
- What is the status of the partners' capital accounts?
- What is the market value of the real estate?
- Gather your docs
  - Recent audits and TRs, tax capital schedule, regulatory agreements, loan agreements

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Results of Sale

Two aspects of dispositions to remember:

- **Cash**
  - Allocation of cash distribution dependent on capital accounts which is affected by gain/loss allocation
- **Taxes**
  - Different tax rates can apply to different kinds of income or gain

LPA vs. IRS

Cash

Partnership Agreement

- States residual split between partners
- Proceeds from sale or refinance subject to liquidation section

Liquidation section

- After payment of liabilities, BUT before the final splits, balance of partnership assets shall be distributed according Partners' capital account balances.
- Determined AFTER all allocations for the year during which the liquidation occurred have been made.

LPA vs. IRS

- IRS says:
  - "*on liquidation*, distributions *must* be made in accordance with capital accounts"
  - Treasury Reg 1.704-1(b)(2)(ii)(b)(2) **"cash is distributed according to positive capital accounts"**

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Gain on Sale – Inputs

Inputs

Sales Price		$7,000,000	
Less: Costs of Sale (Legal + Closing Costs)	-	$150,000	
Net Proceeds			$6,850,000
Land		$2,000,000	
Fixed Assets	+	$15,000,000	
Less: Accumulated Depreciation	-	$10,150,000	
Book Value of Assets Upon Sale (Tax Basis)			- $6,850,000
Gain on Sale			$0

Gain on Sale – Cash Proceeds

Cash Proceeds

Outstanding Debt		$5,000,000
Net Proceeds	$6,850,000	
Less: Debt Paid from Cash Proceeds	- $5,000,000	
Cash Proceeds		$1,850,000

Per the Partnership Agreement

GP Allocation of Cash (80%)	$1,480,000
LP Allocation of Cash (20%)	$370,000

Gain on Sale – Capital Accounts

Tax Basis Capital Accounts

	0.01% General Partner	99.99% Limited Partner	100.00% Total
Balance, 1/1/2016	$100	$1,949,900	$1,950,000
Net Loss from Operations	- $10	- $99,990	- $100,000
Subtotal before Sale, 6/1/2016	$90	$1,849,910	$1,850,000
Distributions from Sale	- $90	- $1,849,910	- $1,850,000
Balance, 12/31/2016	$0	$0	$0

Gain on Sale – LPA vs. IRS/704(b)

Cash Proceeds Comparison

	Per the LPA... Cash	%	Per the IRS... Cash	%
GP	$1,480,000	80.00%	$90	0.005%
LP	$370,000	20.00%	$1,849,910	99.995%

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Exit of LP

- Price is usually greater of:
  - FMV
  - Debt plus taxes
- Important to keep debt + exit taxes less than FMV

Exit of LP

- Don’t need to follow 704(b) cash rules
- Different rules for for-profits and nonprofits (as GP)
- Very important to monitor, manage, and babysit the LP’s capital account, to make sure it doesn’t head too negative
  - Do this early!
  - GP options before year 10
- Lender re-underwriting even with no refi

Nonprofit GPs

- Right of first refusal
  - Under IRC § 42(i)(7), nonprofits often can purchase the property for:
    - Partnership debt; plus
    - Exit taxes, which include:
      - Phantom income from negative capital account
      - State and local taxes attributable to sale
  - If taxes don't exist, then just assume debt

Right of First Refusal

Debt plus exit taxes

Debt $5,000,000

Assume the debt

Exit taxes

Positive tax capital account, no exit taxes

Negative tax capital account, income to get back to zero and then taxes on the income

If their capital account is negative $1 million, you would think:
$1,000,000 x 35% = $350,000 NO!

Instead, it would be $538,462!

Refinancing

- Take out cash to buy out LP
- Can also:
  - Allow owner to recapitalize property
  - Lower debt service/interest rate

Early Buyout of LP

Why does GP want LP to exit early?

- Property has value, or will!
- Option to buyout LP for debt and exit taxes might be less before Y15

Why wouldn't GP want LP to exit early?

- LP might demand lots of money
- Option to buyout LP in Y15 might be cheaper if LP capital projected to be close to zero
- Some LPs demand that the GP post a bond

Early Buyout of LP

Why would LP want to leave early?

- Property has no value; no point in sticking around
- Relieve themselves of asset management duties and other reporting requirements
- Accelerate some tax losses into year of exit and/or potentially avoid exit taxes

Why wouldn't LP want to exit early?

- Property has lots of value! Early exit might forfeit that value
- Greater risk of property going out of compliance without the LP's oversight
- Exposure from extending the statute of limitations on recapture by 3 years
- CRA needs

Early Buyout of LP

- No more bond posting requirement; must have reasonable expectation of continued operation as qualified low-income building
- Beware of 15-year credits
- Usually no contractual mechanism; have to negotiate
- Investor will typically require indemnity and ongoing compliance reporting
- Know your documents - LPA; LURA; Loan documents

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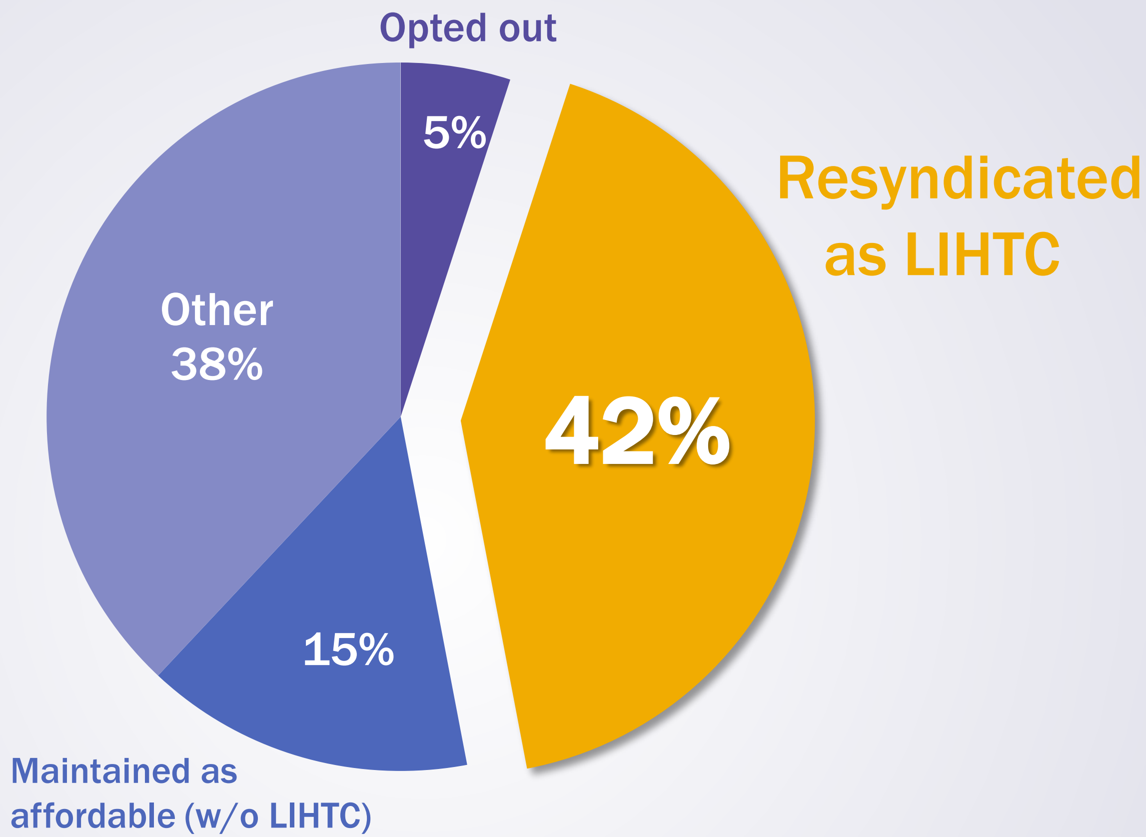

Ernst & Young LLP. "Understanding the Dynamics V: Housing Tax Credit Investment Performance." 2010.

Resyndication

- All about taking an existing property and doing an acq/rehab deal with it
- Have to wait until after Year 15 of the compliance period before you can do it
- Can be very tricky to get the S & U to work – probably need a lot of soft financing
- Property likely will need to be in poor shape with lots of deferred maintenance
  - Investors like heavy rehab
  - Light/moderate rehabs, not so much
  - $30,000-$100,000/unit tends to be the range that works

Issues

- Related party/anti-churning rule
- 10-year hold
- 15-year rule
- Minimum rehab requirements
- Overlapping LURAs

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- LIHTC properties are required to meet initial 15-year compliance period
- Extended use agreement requires an additional compliance period
- IRS: after 14th year, can ask agency to help you sell property. If no buyer surfaces after 1 year, can transition to market after the initial 15-year compliance period

Qualified Contract

- Most projects have waived their right to the QC, so it may not be available
- Process differs by state – get to know your state's process and formula
- Complicated calculation sets the price at which the state must find a buyer

Qualified Contracts in Colorado

- 9% Projects – Extended use agreement of up to 25 additional years of compliance for up to 38 points on application
- 4% Projects – Projects have mandatory 5 year extended used agreement
- Only 1 QCP ever in Colorado

QCP Formula

Outstanding Debt

+ Adjusted Investor Equity

+ Other Capital Contributions

- Cash Available for Distribution

<u>+ FMV of Non-Low Income Portion/Land</u>

Qualified Contract Price

Barriers

- Careful with refis
- QC process doesn't eliminate all contractual restrictions – only eliminates extended use agreement
- Expensive
  - Various third party reports required
- Lots of information requested
- Repeats


Questions?

Year 15 – Options and Strategies

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