STRENGTHMATTERS®

REIMAGINING
REINVENTING
REBALANCING

2021 Financial Management Conference

Nitty Gritty: Y15 Exits – Critical determinants of successful exits and being ahead of the curve

October 27, 2021

Questions

- All participant lines are muted.
- Please use the **Raise Hand** feature if you would like to speak.
  - Raise hand feature is located in the Participant panel.
- You may also use the **Chat** feature to ask questions.
- Send a **Chat** to the Host if you have a technical issue.

Continuing Professional Education Requirements for CPAs

- **Polls are Required for CPEs**
  - If you are seeking CPE credits, please submit ALL polls within each session, and the conference evaluations.
  - If you miss a poll, send a **Chat** message to the Host immediately.
- We use **Polls and the Zoom attendance record** to verify participation throughout the webinar.
  - **Participants must submit ALL polls** and **be logged in no later than 10 minutes after the scheduled session start time to receive a certificate.**

Continuing Professional Education Credits (CPEs) for CPAs

- **Check your Zoom display name**
  - If the correct name is not shown, email your Zoom display name and your full name to consult.lwells@gmail.com.
- You may **request a certificate of completion via the conference evaluations.**
  - Links to the evaluations are emailed to all registrants.
- For more information on CPE credits, contact Lindsay Wells at consult.lwells@gmail.com.

SPEAKERS

Celia D. Smoot, National Affordable Housing Trust
Lisa Deller, National Equity Fund
Len Tatem, Tatem Consulting
Joe Hewitt, National Church Residences

POLL QUESTION 1

Y15 Overview

- Determine when your project reaches the end of the compliance period (Y15)
- Consider your repositioning goals and the investor interest
- Assign staff to work on purchase plan – project manager, legal, accountant
- Gather and review legal and financial documents
  - Identify the LPA purchase price, timing – purchase option or right of first refusal (ROFR), value calculation, waterfall, backend split
- Determine Capital needs
- Assess value – BOV and/or appraisal
- Formulate a purchase plan for ongoing use of the property
- Negotiate exit with the limited partner
- Investor exit and repositioning

When is Y15?

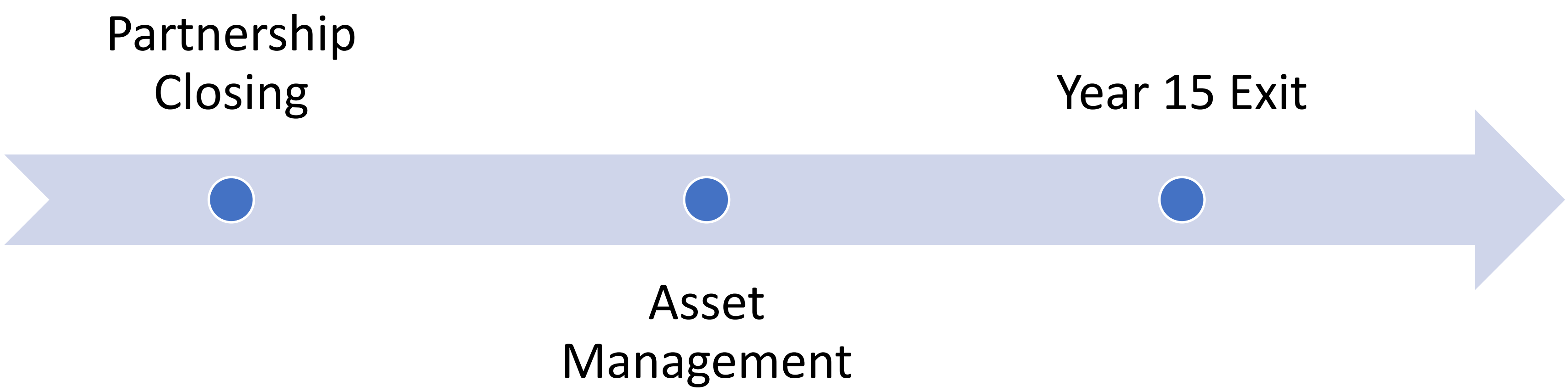
- The end of Year 15 is the last day of the tax year of the 15th year beginning with the first year in which any tax credits were claimed (1st credit year +14 = exit year). Tax credits are claimed in either the year the qualified building was placed in service or the next year. The Form 8609 filed with the IRS indicates when the credits were elected to be claimed.

Part II **First-Year Certification**—Completed by Building Owners with respect to the First Year of the Credit Period

7	Eligible basis of building (see instructions)	7	
8a	Original qualified basis of the building at close of first year of credit period	8a	
b	Are you treating this building as part of a multiple building project for purposes of section 42 (see instructions)?	☐ Yes	☐ No
9a	If box 6a or box 6d is checked, do you elect to reduce eligible basis under section 42(i)(2)(B)?	☐ Yes	☐ No
b	For market-rate units above the average quality standards of low-income units in the building, do you elect to reduce eligible basis by disproportionate costs of non-low income units under section 42(d)(3)(B)? ▶	☐ Yes	☐ No
10	Check the appropriate box for each election: *Caution: Once made, the following elections are irrevocable.*		
a	Elect to begin credit period the first year after the building is placed in service (section 42(f)(1)) ▶	☐ Yes	☐ No
b	Elect **not** to treat large partnership as taxpayer (section 42(j)(5)) ▶	☐ Yes	
c	Elect minimum set-aside requirement (section 42(g)) (see instructions) ☐ 20-50 ☐ 40-60	☐ 25-60 (N.Y.C. only)	
d	Elect deep rent skewed project (section 142(d)(4)(B)) (see instructions)	☐ 15-40	

Disposition timeline

- A LIHTC developer should be thinking about the disposition process from the very beginning - even before a deal closes. The extra penny per credit your equity partner might pay to win a deal could pale in comparison to the cost to exit at Y15.



Disposition timeline

- It's going to take time to work through the legal, financial and investor issues to exit a project.

- If you've done preliminary work up front and been a good asset manager throughout the life of the project, it will be easier.

- Early exit?
  - depends on the project physical and financial condition and investor expectations
  - start early if you think an early exit is desirable and feasible
- Otherwise….

Two to three years before Y15 - determine project viability

- Examine current operations
  - evaluate present and potential financial conditions

- Investigate market trends and determine value
  - Understand how the property is positioned relative to market trends and ongoing rent restrictions. Order an appraisal or obtain a Broker’s Opinion of Value.
- Consider operating expenses and debt service
  - Analyze the current operations of the project and future needs, including utilities and insurance, salaries, tax abatements, etc. Will net operating income be sufficient to service new and/or assumed debt?
- Identify capital needs

Assembling Documents for a Purchase Plan

Partnership Agreement

- Purchase Option and ROFR – terms and timing of acquisition/sale
- Valuation of property
- Disposition of reserves – operating and replacement
- Capital account deficit restoration requirements

Debt Agreements

- Outstanding balances
- Terms related to sale
- Mortgage repayment terms
- Consents required to transfer ownership
- Reserves regulations
- Restrictive covenants of funding that could impact valuation – LDA, land lease, extended use agreements

Other Agreements

- Land Use Regulatory Agreement (LURA) - continued monitoring by HFA/ allocating agency
- Other reporting requirements

- HFA
  - Land Use Regulatory Agreement (LURA) – extended affordability, physical condition, tax benefits, control of reserves

Pulling it all together

- Formulate a purchase plan for ongoing use of the property
  - Get to know your Limited Partners
  - What will it take to own the property well for the next 15 years?
  - How will the property needs be financed?
    - Debt restructuring, new conventional debt, assume debt, bond allocation, resyndication, use of reserves, future partnership opportunities, sale of the asset.
  - Obtain organization board involvement
  - Stakeholder relationships – is there political support for preserving the property?

Resources

- Consortium for Housing and Asset Management (CHAM) webinars
  - New Initiatives to Deter Year 15 Right of First Refusal Disputes, May 2021
  - Year 15 Dispositions: Navigating the Challenges with Purchase Options and Rights of First Refusal, September 2020
- National Equity Fund https://www.nationalequityfund.org/partnerportal/developers/developing-a-15-year-transition-plan/
- Affordable Housing Investors Council Dispositions Discussion Paper, 2018
- LISC, Refinanced and Reborn: Planning for the Year 15 Transition of Your Tax Credit Projects

Capital Needs Assessment

- Don't wait until a recapitalization is being contemplated to make assessment of the capital needs of the property.
- Include the onsite property management and maintenance staff in the assessment and not just rely on the PCNA provider.

  (Who is likely to have the memory regarding the fire that happened 5 years ago in Unit 2B)
- Make determination and cost out the needed repairs and upgrades

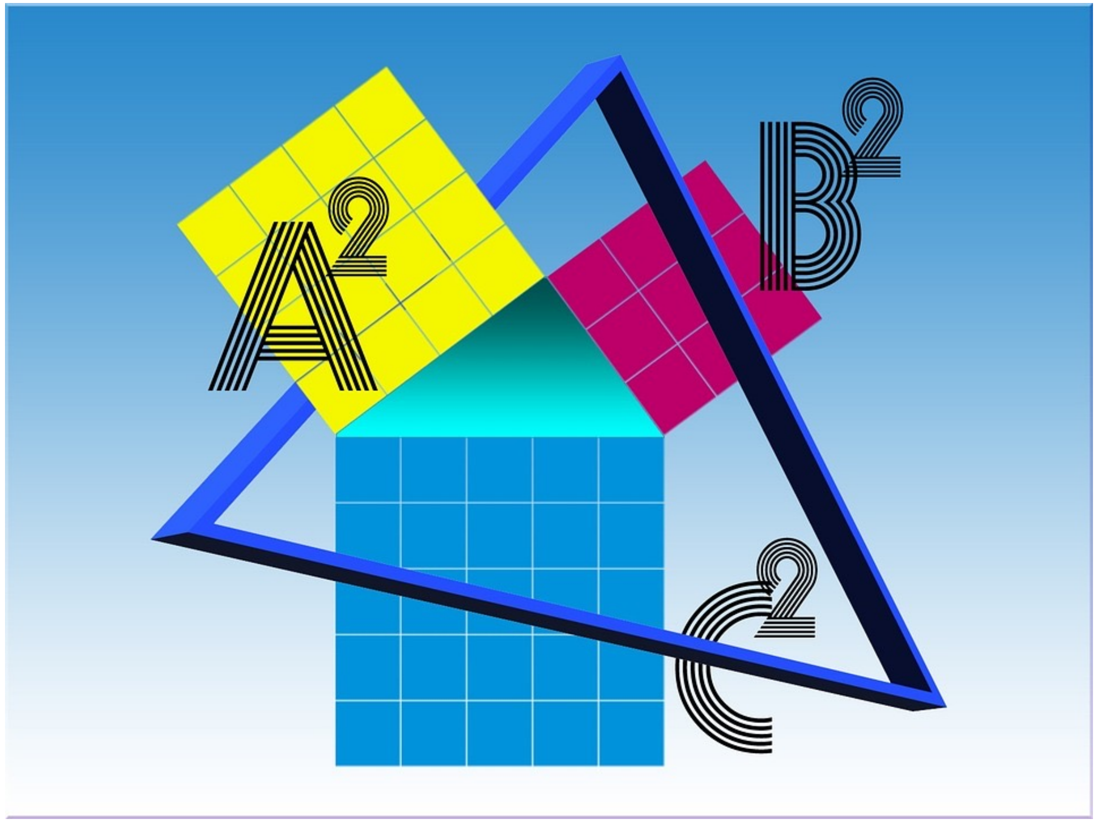
BECAUSE…..


That's a surprise tool that will help us later

Mathematics of Year 15

BEST PRACTICES

- ✓Review the capital accounts
- ✓Review the investor benefits
- ✓Review the investor losses
- ✓Understand the tax returns and the K-1s
- ✓Forecast the results annually
- ✓Compare the results to the underwriting



Mathematics of Year 15

While documents and the associated references are important in preparing your calculations and financial statement remember that:

RELATIONSHIPS MATTER TOO!

Mathematics of Year 15

What is a Partnership Capital Account?

The partnership capital account is an equity account on the “books” of a partnership.

Mathematics of Year 15

THE COMPOSITION OF CAPITAL ACCOUNTS

- Initial and subsequent contributions by partners to the partnership, in the form of either cash or the market value of other types of assets
- Profits and losses and earned by the business, and allocated to the partners based on the provisions of the partnership agreements.
- Distributions to the partners
- The ending balance in the account is the undistributed balance to the partners as of the current date

Mathematics of Year 15

CAPITAL ACCOUNTS

- A partnership can maintain a single partnership capital account for all partners, with a supporting schedule that breaks down the capital account for each partner.
- It is easier to maintain separate capital accounts within the accounting system for each partner making it is easier to determine the amount to be distributed to each partner in the event of a liquidation of the business or the departure of a partner, which in turn reduces the amount of discussion over payments and liabilities amongst the partners.
- All of this will be reflected on the K-1's for the partnership.

Mathematics of Year 15

FORECASTING CAPITAL ACCOUNTS

- For a tax credit deal forecasting the capital accounts is not only a best practice, it is easy to do.
- While you will calculate the capital account during the audit process, it is also a best practice to calculate it during the annual budget process.
- The technique to calculate the account is very simple. A great tip is included in the NEF publication: "Developing A Year 15 Transition Plan."

EXAMPLE OF A CAPITAL ACCOUNT FORECST

Computation for the Tax	Date of Last Bin Placed In Service (source is original 8609's)	2019
A	Year of the Most Recent Completed Tax Return	2021
B	Limited Partner's Capital Account Balance Shown in the Most Recent Tax return - From 1065 L Ending Capital Account Balance	$ 3,300,000
C	Taxes losses for Year - Box L current year increase or decrease (Show as a negative number)	$ (250,000.00)
D	Number of Years Until the Sale	13
E = C * D	Total Additional Projected Losses (show as a negative number)	$ (3,250,000)
F = B + E	Projected Limited Partner Capital Account at Sale (if this box is a positive number there will be no exit taxes	$ 50,000
G = F 8 .35 *1.35*-1	Tax on Sale - Only if (f) is a Negative Number; Tax is expressed as a positive number	$ -

Mathematics of Year 15

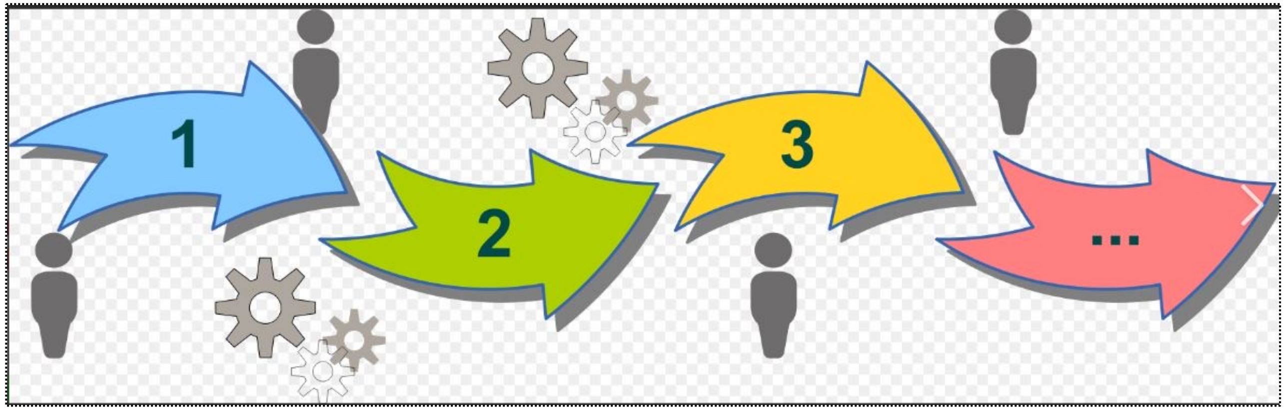
TAX LIABILITY

- Estimating Exit Tax Liability Exit tax liability is based on the information provided in the limited partnership's tax return Form 1065, Schedule K-1.
- Since the year 15 tax return may not yet be available at the time of the evaluation, the previous year's tax return will be used, and an estimated one-year adjustment will be made. The limited partner’s capital account information is located in Section J, titled, Analysis of Partner’s Capital Account.
- If the amount shown for the limited partner's capital account in box J(e) is negative, the following exit tax calculation will be applied: Negative capital account balance x 0.35 (investor's federal tax rate) Note: This federal tax rate is actually lower right now.
- In some cases, investors may require that the project accountant provide a reconciliation between GAAP and tax accounting to determine the tax liability, if there is a question regarding the presentation of capital accounts on partner

Mathematics of Year 15

EXITS INVOLVE ONE OF THREE TYPES OF TRANSACTIONS:

- Qualified Contract
- Right of First Refusal
- Sale of Partnership



Mathematics of Year 15

§ 1.42-18 QUALIFIED CONTRACTS

- **(a)** ***Extended low-income housing commitment*** -
- **(1)** ***In general.*** No credit under section 42(a) is allowed by reason in section 42 with respect to any building for the taxable year unless an extended low-income housing commitment (commitment) (as defined in section 42(h)(6)(B)) is in effect as of the end of such taxable year. A commitment must be in effect for the extended use period (as defined in paragraph (a)(1)(i) of this section).
- **(i)** ***Extended use period.*** The term *extended use period* means the period beginning on the first day in the compliance period (as defined) in section 42(i)(1)) on which the building is part of a qualified low-income housing project (as defined in section 42(g)(1)) and ending on the later of -
- **(A)** The date specified by the low-income housing credit agency (Agency) in the commitment; or
- **(B)** The date that is 15 years after the close of the compliance period.
- **(ii)** ***Termination of extended use period.*** The extended use period for any building will terminate -
- **(A)** On the date the building is acquired by foreclosure (or instrument in lieu of foreclosure) unless the Commissioner determines that such acquisition is part of an arrangement with the taxpayer ("the owner") a purpose of which is to terminate such period; or
- **(B)** On the last day of the one-year period beginning on the date (after the 14th year of the compliance period) on which the owner submits a written request to the Agency to find an appropriate organization to acquire the owner's interest in the low-income portion of the building if the Agency is unable to present during such period a qualified contract for the acquisition of the low-income portion of the building to operate such portion as a qualified low-income building (section 42(c)(2)).
- **(iii)** ***Owner non-acceptance.*** If the Agency provides a qualified contract within the one-year period and the owner rejects or fails to act upon the contract, the building remains subject to the existing commitment.

Mathematics of Year 15

QUALIFIED CONTRACT

Add :	
Outstanding Debt At Year 15 / Exit Year	-
Return on and Return of Equity (Original Contribution)	-
Contribution Escalator- Annual CPI	-
Less :	
Cash Distributions as defined by IRS	-
Cash Available for Distributions	-
Total :	-
Low Income Fraction:	100%
Qualified Contract Purchase Price:	-

RIGHT OF FIRST REFUSAL

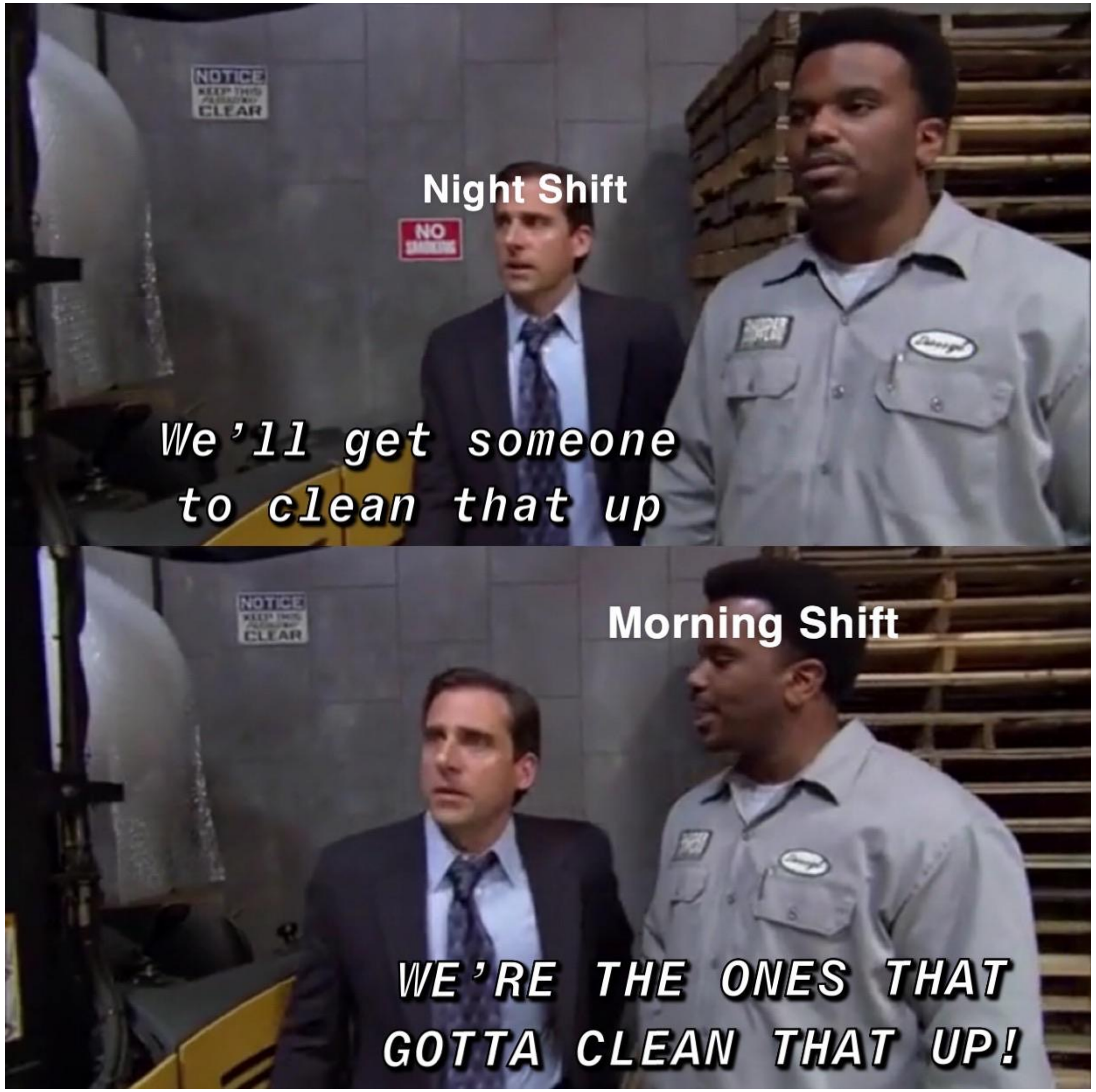
	Amount
Projected Debt Balances at Year15	
Accrued Interest (all loans)	-
Total Outstanding Debt	-
Current Reserve Balance	-
Projected change thru Y15	
Reserve Balance at end Yr15	-

Outstanding Debt at Exit		-
Exit Taxes		-
Total Debt + Exit Taxes		-
Any Other Adjuster:		-
	Purchase Price	-
Transaction Costs @ 2.5%		-
	Total Price	**-**
	Cash Needed Beyond Existing Debt	**-**
	Per unit Price	#DIV/0!

POLL QUESTION 2

CAPITAL ACCOUNTS

- Reviewing capital accounts is more than just exit tax management
- Inducement (and LIHTC pricing) of investment is CRA, Losses, Credits and RETURN!
- While most LPAs do not have yield/ return maintenance provisions it is part of the bargain of the partnership
- Phantom Income


Night Shift
We'll get someone
to clean that up
Morning Shift
WE'RE THE ONES THAT
GOTTA CLEAN THAT UP!

Waterfall / Liquidation – Fair Market Value

SAMPLE - FMV Disposition, Liquidation, Capital Account Analysis							
Projected NOI			+				
Cap Rate			+				
Projected Sales Price		10,000,000		Per Mid Price BOV			
Broker Fee	3.00%	(300,000)					
GP Fee	0.00%	0					
Incentive Management Fee		0	-				
Title and Closing		(40,000)	-				
Sales Proceeds		9,660,000					
Capital Improvement Deduction		0	-				
Proceeds from Sale		9,660,000					
Debt		(5,000,000)	-				
Prepayment Penalty			-				
Net Sales Proceeds		4,660,000					
Net Liquid Assets		776,500					
Cash Available for Distribution		5,436,500					
Add Assets							
Cash		200,000	+	*Liquid*			
Accounts Receivable		20,000	+				
Prepaid Expenses		15,000	+				
Net Intangibles			+				
Tenant Security Deposits		35,000	+	*Liquid*			
Replacement Reserve		300,000	+	*Liquid*			
Tax & Insurance Escrow		60,000	+	*Liquid*			
Other Reserves		300,000	+	*Liquid*			
		930,000					
Less Liabilities							
Accounts Payable/Accrued Exp		(15,000)	-	*Liquid*			
Fees Payable		(7,500)	-				
Accrued Interest - 1st		(8,500)	-	*Liquid*			
Current Debt Maturities - 1st		(60,000)	-	*Liquid*			
Due to Related Parties			-				
Accrued Interest			-				
Tenant Security Deposits		(35,000)	-	*Liquid*			
		(126,000)					
Waterfall - Net Sales Proceeds		LP 1				GP	5,436,500
Reserves for Contingent Liabilities							5,436,500
Repayment of Voluntary Loans							5,436,500
Administrative/AM Fees Payable		7,500					5,429,000
Repayment of Deferred Developer Fee							5,429,000
ILP Return of Capital							5,429,000
GP Return of Capital							5,429,000
ILP Portion	99.99%	5,428,457		0			
GP Portion	0.01%					543	
		5,435,957		0		543	5,436,500

Waterfall / Liquidation - ROFR

SAMPLE - ROFR
Disposition, Liquidation, Capital Account Analysis

Projected NOI			+			
Cap Rate			+			
Projected Sales Price		5,068,500		Outstanding Debt and Interest		
Broker Fee		0				
GP Fee	0.00%	0				
Incentive Management Fee		0	-			
Title and Closing			-			
Sales Proceeds		5,068,500				
Capital Improvement Deduction		0	-			
Proceeds from Sale		5,068,500				
Debt		(5,000,000)	-			
Prepayment Penalty			-			
Net Sales Proceeds		68,500				
Net Liquid Assets		776,500				
Cash Available for Distribution		845,000				
Add Assets						
Cash		200,000	+	*Liquid*		
Accounts Receivable		20,000	+			
Prepaid Expenses		15,000	+			
Net Intangibles			+			
Tenant Security Deposits		35,000	+	*Liquid*		
Replacement Reserve		300,000	+	*Liquid*		
Tax & Insurance Escrow		60,000	+	*Liquid*		
Other Reserves		300,000	+	*Liquid*		
		930,000				
Less Liabilities						
Accounts Payable/Accrued Exp		(15,000)	-	*Liquid*		
Fees Payable		(7,500)	-			
Accrued Interest - 1st		(8,500)	-	*Liquid*		
Current Debt Maturities - 1st		(60,000)	-	*Liquid*		
Due to Related Parties			-			
Accrued Interest			-			
Tenant Security Deposits		(35,000)	-	*Liquid*		
		(126,000)				
Waterfall - Net Sales Proceeds		LP 1		LP 2	GP	845,000
Reserves for Contingent Liabilities						845,000
Repayment of Voluntary Loans						845,000
Administrative/AM Fees Payable		7,500				837,500
Repayment of Deferred Developer Fee						837,500
ILP Return of Capital						837,500
GP Return of Capital						837,500
ILP Portion	99.99%	837,492		0		
GP Portion	0.01%				84	
		844,992		0	84	845,075

POLL QUESTION 3

Aggregator Alligators

- Entities acquire limited partnership interests in LIHTC deals mostly after the 10 year credit period and attempt to extract value at Y15 Disposition.
- Recent litigation focused on Nonprofit rights under the statutory Right of First Refusal for the most part has been on the side of the nonprofits but there is nuance in some of the legal opinions.
- Advocate for proposed legislation to reinforce ROFR rights and clarify that those ROFR rights apply to the fee simple property and the partnership assets.
- State HFAs are trying to be more proactive in providing support to GPs regarding LP exits like requiring consent or prohibiting project funds/ reserves to be distributed for LP exits.
- Current LPA negotiations to prohibit or require consent by GP of LP interest and upper tier transfers to Aggregators. Relies on knowing who are and who will be the Bad Boys and Girls in the future …..


...and you don't

QUESTIONS??

CONTACT INFORMATION

Celia D. Smoot
Vice-President
NAHT
csmoot@naht.org

Lisa Deller
Vice-President
NEF
ldeller@nefinc.org

Len Tatem
Principal
Tatem Consulting
tatemconsult@att.net

Joe Hewitt
Director of Dispositions
NCR
JHewitt@nationalchurchresidences.org

CPE Feedback Poll

- If you are seeking CPEs, please complete this brief feedback poll.
- Note: All registrants will receive links to the conference evaluations via email.
  - Please complete the conference evaluations to request CPE credit and to provide qualitative feedback.