Housing Colorado NOW! Annual Conference

Year 15 is Coming

Issues for a Low-Income Housing Tax Credit Partnership

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Agenda

- Preparing for Year 15
- Early Buyout of LP
- GP Purchase of LP Interest
- Exit strategies and tax consequences

Preparing for Year 15 – In General

- It is never too early to start planning for Year 15.
  - This planning should start before the initial closing on the property
- Review and familiarize yourself with applicable executed agreements.
  - What you remember or believe - is probably wrong!
- Review disposition plan from original underwriting financial projections.
- Initiate discussions with investors regarding possible exit strategies.
- Analyze tax capital accounts and estimate possible exit taxes.
- Accumulate all prior year returns.

Preparing for Year 15 - Timeline

- **Prior to initial closing**
  - Prepare underwriting financial projections
  - Discuss puts, calls, etc.

- **Years 1 - 7**
  - Compare actual activity to financial projections
  - Identify potential 704(b) tax capital issues

- **Years 8 – 10**
  - Initiate discussions regarding potential exit strategies
  - Analyze the partners' tax capital accounts
  - Analyze the outstanding debt of the partnership

Preparing for Year 15 - Timeline

- **Years 11 - 15**
  - Continue discussions regarding exit strategies
  - Apply for Qualified Contract Process with State Housing Agency, if applicable (Year 15)

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 year 15

- **Why wouldn't GP want LP to exit early?**
  - LP might demand lots of money
  - Option to buyout LP in year 15 might be cheaper if LP capital is 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 yourself 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
  - Don’t trust GP to keep property compliant
  - Exposure from extending the statute of limitations

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, plead, cajole, etc.
- LP must agree to extend SOL
- Investor will typically require indemnity and ongoing compliance reporting
- Know your documents – LPA; LURA; Loan documents

GP Purchase of LP Interest

- Recent market trend?
- Avoid dispute regarding which distribution provision applies
- Purchase price = “Residual interest price”
- Sample LPA Language:

“The parties agree that in lieu of a purchase of the Apartment Complex, the GP may instead purchase the interests of the LP at the Residual Interest Price. Residual Interest Price shall mean an amount equal to 10% of the Equity Value plus any amounts due to the LP pursuant to this agreement.

Equity Value shall mean the value of the Apartment Complex as a going concern (taking into account any regulatory and use restrictions) based on the FMV as determined by an Appraiser, reduced by (i) existing secured debt, and (ii) costs of the transaction.

GP Purchase of LP Interest

- Flip Agreement
- Option's "Put" / "Call" provision
- Potential tax issues:
  - Agreement to sell for less than FMV?
  - Undercuts 704(b) allocations so no longer satisfy safe harbor?

The Ideal

		GP	LP
Sales Price	10,000,000		
Assets	8,000,000		
Debt	8,000,000		
Capital Account	0	0	0
Gain	2,000,000	1,800,000	200,000
Cash Distribution	(2,000,000)	(1,800,000)	(200,000)
Ending Capital Account		0	0
Cash Split		90%	10%

The Not As Good

		GP	LP
Sales Price	10,000,000		
Assets	8,000,000		
Debt	7,500,000		
Capital Account	500,000	0	500,000
Gain	2,000,000	1,800,000	200,000
Cash Distribution	(2,500,000)	(1,800,000)	(700,000)
Ending Capital Account		0	0
Cash Split		72%	28%

The Ugly

		GP	LP
Sales Price	10,000,000		
Assets	10,000,000		
Debt	8,500,000		
Capital Account	1,500,000	0	1,500,000
Gain	0	0	0
Cash Distribution	(1,500,000)	0	(1,500,000)
Ending Capital Account		0	0
Cash Split		0%	100%

Exit Strategies and Tax Consequences

- **Sale of the property**

  - Potential buyers:
    - General partner
    - Related party
    - Residents
    - Third-party buyer

  - Review partnership agreements for the following:
    - Cash distribution waterfall of sales proceeds
    - Allocations of the gain/loss on sale

Exit Strategies and Tax Consequences

- **Sale of partnership interest**
  - Investor may sell its partnership interest to the general partner.
  - General partner may exercise call option to buy the investor’s partnership interest.
  - Amount realized by investor includes the amount paid by the buyer plus the amount of debt of which the investor is relieved.
  - Investor’s tax basis includes its tax capital account balance plus its share of liabilities.

Exit Strategies and Tax Consequences

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

Exit Strategies and Tax Consequences

- **Bargain sale of property or partnership interest**
  - Will be treated as part sale and part charitable contribution of property.
  - Will need an appraisal to determine fair market value of the property.
  - Amount of the charitable contribution is the fair market value of the property in excess of the proceeds received by the partnership
  - Basis of the property must be allocated between the amount contributed and the amount sold.

Exit Strategies and Tax Consequences

- **Re-syndication**

  - The owner of the property would need to check the qualified allocation plan in a specific state for an specific requirements for re-syndication and compliance.

  - The owner must incur at least $6,000 per unit of rehabilitation costs within a 24-month period.

  - The deal needs to meet the 10-year rule to be able to claim acquisition credits.

Exit Strategies and Tax Consequences

- **Qualified Contract Process**
  - Qualified contracts can be exceptionally complex
  - Determine if property is eligible to go through this process.
    - Various states such as California don't have a regulatory agreement that provides for qualified contract options
  - Review state housing agency requirements.
  - Calculation of the qualified contract price is dictated by Internal Revenue Code Section 42(h)(6)(F)(i)(I).
    - IRC § 42(h)(6)(F) and Treas. Reg. § 1.42-18 don't answer all of the questions of qualified contracts
  - Will need appraisal for the non-low income portion of the building(s).

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