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OPA-LOCKA COMMUNITY DEVELOPMENT CORPORATION

Navigating the Challenges at Year-15 with Difficult Partners in LIHTC Partnerships

Opa-locka Community Development Corporation Case Study

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Low-Income Housing Tax Credits - Defined

- Primary subsidy available for developing and preserving affordable rental housing
- Keeps rent affordable to those making 60 percent or less of the area median income (AMI)
- State Housing Finance Agencies (HFAs) develop a competitive scoring system, with selection criteria outlined in the HFA's Qualified Allocation Plan (QAP) or similar documents
- The policies and priorities outlined in a QAP have a significant impact on the types and location of affordable housing that is developed
- www.ncsha.org

Housing Tax Credits 101

- Equity provides 70%-90% of development cost, reducing debt service and thereby lowering rents
- Amount of credit is determined as percentage of a project's qualified cost basis
- 9% Credit: 90% of qualified project costs over 10 years
- 4% Credit: 40% of qualified project costs over 10 years
- Credits are a dollar for dollar permanent reduction in tax liability and can be carried back 1 year & forward 20 years
- Investors are also entitled to depreciation and other deductions further reducing taxable income.

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LIHTC Eligibility & Compliance

Key Risks

- Foreclosure by the lender entitles the lender to the remaining tax benefits
- If lender takes the property out of compliance up to 1/3rd of credits already claimed can be recaptured

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Current State of LIHTC Market

- About $10B-$13B market annually
- "CRA Investors": Banks driven by regulatory requirements to make social investments. Target properties in locations that match concentration of their deposits. Usually accept lower yields
  - Largest seven banks by deposits account for as much as 80% of the market, each investing $500M-$1,000M+ through Private label and Multi-investor funds and Direct Investments (Wells Fargo, Bank of America, JPMorgan, Citi, US Bank, PNC, Capital One)
- "Economic investors": Driven strictly by risk adjusted returns. Less sensitive to location of properties
  - Economic investors include: Northwestern Mutual, Allstate, Allianz, USAA, Western Southern, MetLife, NY Life, Anthem, State Street, Berkshire Hathaway, Goldman Sachs

Key Considerations LIHTC Credit

> Compliance with CRA Investment test
  - Most banks invest in LIHTC asset class to meet the CRA investment test requirements, equivalent to 25% of the bank's overall CRA performance.

> Multi-investor national fund:
  - Single investor can receive CRA credit for its invested equity for a specific property in the fund (matching its assessment area), disproportionately to their ownership percentage (up to their investment amount)
  - Investor purchases 10% of equity in the fund and is therefore economically invested into each property at 10% level. For CRA purposes, investor can assign 100% of its equity to a specific property and 0% to other properties

> Multi-investor state or regional fund: CRA credit is allocated proportionately to each property based on investor's ownership percentage

> Proprietary / Single investor fund: Properties are selected in the bank's CRA footprint

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Key Considerations LIHTC Credit (cont.)

LIHTC deals are selected in the bank's CRA footprint and may provide banks with lending opportunities for the properties acquired. Based on regulatory oversight most banks' performance for CRA purposes are assessed on their lending in low and moderate income communities and also their performance for community development lending is weighted heavily when creating affordable housing and multi-family rental units.

Therefore LIHTC helps address the Investment performance and lending performance for banks and creates an excellent return on investment with low risk. Even when foreclosure of the property is required, the lender is still entitled to the remaining tax benefits. However the foreclosure rate for *tax credit properties have a cumulative foreclosure rate of just 0.65%, the annual rate of foreclosure is even lower than the cumulative rate –typically less than 0.1% in any year since 2000.*

YEAR 15-EXIT DISPUTES

- Historical understanding and practices
- Emergence of Aggregators
- Litigation discussion

Types of YR 15 Rights

- Right of First Refusal – Code Section 42(i)(7)
- Purchase Option
  - GP Option to buy LP interest at fair market value (FMV)
  - GP Option to buy project at FMV
- Puts/Calls
- Continue to operate as-is and hold
- Re-syndicate the project
- Sale of the project
- Qualified Contract
- "Forced sale" requirements

Right Of First Refusal (ROFR)

> Section 42 creates a unique, statutory right — the § 42(i)(7) ROFR — available *only* to non-profit participants

> ROFR added to Section 42 in 1990

> No Federal income tax benefit will fail to be allowable merely by reason of:

- A ROFR to purchase the property after the close of the Compliance Period
- Held by Certain Eligible Holders
- For a specified Minimum Purchase Price

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Internal Revenue Code Section 42(i)(7)

Under IRC § 42(i)(7) nonprofits often can purchase the property for

Partnership debt + 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

Aswan Village Apartments

Strategy Locally and Nationally

- Amending nonprofit definition
- Mandatory ROFR
- Creating additional goals/preferences/tiebreakers in RFA's for nonprofit deals
- Have counties give large land grants to nonprofits

- Benefit of nonprofit participation/ROFR
  - Real estate tax relief/lower operating expenses/better economic project
  - Increased likelihood of long-term affordability

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Considerations When Negotiating a ROFR

- Let your development partner know early on that you will not do the partnership unless you have a Section 42 ROFR
- Put that right in any LOI or MOU you negotiate BEFORE any tax credit or other applications for funding are submitted
- Make sure you have approval rights prior to year 15 on sale of the property and include other membership transfer approvals
- Get counsel to represent your organization from the beginning of the negotiations through financial closing
- Make sure it's a clean Section 42 ROFR, try not to let your partner or investors limit your rights by putting in qualifying language
- Stay on top of the Project and financials throughout the term of the Project and prepare/hire a competent consultant to get you through once tax credit period up (around the time investors start to think about exiting the deal)
- Remember your negotiating power depends on what your organization is bringing to the deal

Considerations when Negotiating ROFR (cont.)

- Statutory purchase price is a minimum price that doesn't include accrued but unpaid amounts due to LPs such as fees or loans
- ROFR is not automatic: it must be included in partnership documents + exact terms negotiated
- Look to the sales proceeds waterfall in the partnership to see how proceeds are distributed
- The parties do not have to use the ROFR in year 15

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Call to Action

- Advocate for policies, such as:
  - Mandate ROFRs; have them never expire
  - Increase nonprofit participation in new deals
  - Increase nonprofit capacity
  - Have counties give large land grants to nonprofits
- Share news of this court decision widely
- Remain vigilant in own transactions
- Send letters of support to NGOs in other litigation matters

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THANK YOU

QUESTIONS?

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