1. Workshop
   a. Low Income Housing Tax Credit Project

   Documents:
   
   TOF LIHTC Memo 4-11.Pdf
   LIHTC 101 SB.pdf
   Mill Avenue Fraser Apts Structure Diagram 2-25-19.Pdf
   Mill Avenue Fraser Apts Year 15 3-1-19.Pdf
   RHLS ISSUES FOR NONPROFIT CORPORATIONS CONSIDERING PARTICIPATING IN LOW INCOME HOUSING TAX CREDIT PROJECTS1.Pdf
Memo

To: Fraser Town Board
From: Sarah Batt
Date: April 11, 2019
Re: Issues to consider with possible LIHTC project

This memo addresses the issues involved with the town serving as general partner in a Low Income Housing Tax Credit (LIHTC) development. A developer has proposed to develop a 9% LIHTC project just outside the town limits of Fraser. The developer is willing to take on the pre-development and construction responsibilities but is proposing that the town take on the general partnership and operational roles for the project. This memo will attempt to provide detail on the responsibilities that accompany acting as general partner of a LIHTC development.

I have attached a memo that details the different roles to play in a LIHTC partnership and I think it does a great job of explaining who does what and decision points before entering a project. It comes at it from the perspective of a nonprofit GP but most of the issues are the same.

I am also attaching a simple LIHTC 101 Power Point. It’s not perfect but I hope it gives you all an overall sense for the projects. Additionally, I am including a 1 pager on Year 15 exit options for the town and Proposed Structure diagram from the developer (this is not set in stone)

I am going to address guarantees that developer would like the town as general partner to take on. Those are as follows:

1) LIHTC adjustors
2) Operating deficits
3) Recapture of LIHTC

I am also going to discuss exit provisions at the end of the 15 year compliance period.
ADJUSTERS

Adjusters are guarantees related to delivery of credits. When you close on the partnership you agree to complete the project and lease up the units in a very specific time frame. The issue for the investor is when you complete the building(s) that “places it in service” and when you lease up a unit with a qualified tenant that delivers to the investor the credit for that unit. The investor is paying equity into the project based on that agreed upon delivery timing. To the extent that the project does not deliver, the partnership agreement has adjusters in place to make them whole for the loss of credit. There are three types of adjusters to be concerned with 1) slow timing – slow lease up first year or 2) Initial timing-missing leasing up by the end of the first year, 3) Performance Adjuster

EXAMPLE from Town of Breckenridge deal- Proposed lease up schedule

<table>
<thead>
<tr>
<th>Month</th>
<th>Credits</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aug-16</td>
<td>7</td>
</tr>
<tr>
<td>Sep-16</td>
<td>8</td>
</tr>
<tr>
<td>Oct-16</td>
<td>10</td>
</tr>
<tr>
<td>Nov-16</td>
<td>10</td>
</tr>
<tr>
<td>Dec-16</td>
<td>10</td>
</tr>
<tr>
<td>TOTAL</td>
<td>45</td>
</tr>
</tbody>
</table>

Short fall in year one - First example is slow - second is if you don't lease up all the units in 2016-

<table>
<thead>
<tr>
<th>Credits in 2016</th>
<th>Credits in 2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proposed lease up</td>
<td>$78,160</td>
</tr>
<tr>
<td>5, 5, 12, 12,11</td>
<td>$71,390</td>
</tr>
<tr>
<td>39 in 2016, 6 in Jan 17</td>
<td>$0</td>
</tr>
</tbody>
</table>

A general way to calculate the credit adjuster is to take the difference in the credits and multiply it times 60%. That gets you to the approximate present value calculation described in the LPA. Or you can run the actual calculation in excel by calculating present value of the difference at the discount rate for 10 years. That gives you the value of the credits today and you take the difference between the difference and the present value of getting it in 10 years.

So under scenario #1, the adjuster would be approx. $4k.

Scenario #2-since this is 1 building, it either has to be fully occupied by 12/31 or we have to take the F-1 election which lets us defer the credit period 1 year. So if it's not full by 12/31, we wouldn’t get any credits in 2016. The adjuster would be approx. $48k.
Performance adjuster relates to if there is a recapture during the compliance period. This is something that the property management company needs to manage and perhaps the town’s agreement with the property manager would put this guarantee on them.

(this is sample adjuster language from one investor’s partnership agreement)

1. Change in Credits: The Capital Commitment contributions are based on actual credits delivered. If actual Total Credits are less than the estimated amount, the Capital Commitment will be reduced by the shortfall times the Credit Price. The foregoing adjuster will apply if actual credits are less than the estimate for any reason. If actual Total Credits are greater than the estimated amount (“Excess Credits”), then the Total Capital will be increased by an amount equal to the Excess Credits times the Credit Price, but Total Capital shall not exceed 105% of the Capital Commitment unless further approved by the Fund. Fund will specify the terms, if any, under which it will purchase any Excess Credits attributable to an additional reservation of Credits, and/or those that would otherwise cause capital contributions to exceed 105% of the Capital Commitment. If those terms provide for a credit price less than the Credit Price, the General Partners can accept or reject those terms. Any Excess Credits that the Fund is unwilling to buy or that the General Partners are unwilling to sell at the price specified by the Fund shall be allocated to the General Partners.

2. Timing Adjuster: The Capital Commitment of the Fund shall be reduced by [$0.00] per credit of the shortfall between the Credits actually delivered and the Credits estimated to be delivered in each year of 2020 and 2021. Currently, it is estimated that the Partnership will deliver (i) [$000,000] of Credits in 2020 and (ii) [$0,000,000] of Credits in 2021.

3. Timing Adjuster – Early Delivery: In the event that the actual Credits with respect to the first Credit Year are more than the Credits projected for such years, then the Capital Commitment of the Fund to the Partnership shall be increased by an amount (the “Upward Timing Adjustment”) equal to [$0.00] of such excess; provided, that any such increase is subject to the overall limitation that Fund Total Capital cannot exceed 105% of the estimated Capital Commitment without Fund consent. The Upward Timing Adjustment shall be made and applied to increase the Final Capital Contribution. It is understood and agreed that the Upward Timing Adjustment is intended to address any acceleration in the delivery of the first year of the Credit Period from the projected Credit amounts during such year where the total projected Credits for the entire Credit Period is not affected and that this Upward Timing Adjustment may be decreased if and when the Fund determines in
the exercise of its sole and absolute discretion that a smaller Upward Timing Adjustment must be paid in order to maintain the expected return on investment.

Operating Deficit Guarantee

This comes into play initially once the construction is complete but before the property stabilizes and then the guarantee evolves to be in place for a certain number of years of operations (depend on the investor). The Stabilization definition below is a sample from the town of Breckenridge LP agreement. I chose this because the investor on that deal maybe the same on this deal. Stabilization definitions can vary from investor to investor. The way the operating deficit guarantee is handled varies by investor as well. Often the amount of the guarantee is capped once you get past stabilization. It’s usually capped at the operating reserve amount.

So in your deal right now the operating reserve is sized at $276,000. This is funded from equity as part of the development budget and held jointly in a bank account. That is 6 months of debt service and operating. Ideally, your guarantee would be capped at that amount once you got past stabilization. Many investors will allow you to use the operating deficit reserve to fund operating deficits (!) up to a point, 50% typically. But tapping into the operating reserve will extend the operating deficit guarantee. You cannot get out from under the guarantee until the reserve is fully funded at the amount agreed upon at closing and you have not run any deficits for a few years.

“Stabilization” means the later of (i) date certain ___ and (ii) the first date on which all of the following conditions have been satisfied: (A) as determined by the Accountants, the Apartment Complex has maintained, for three (3) full consecutive months of operations following receipt of final certificates of occupancy for each unit in the Apartment Complex, an Expense Coverage Ratio of 1.15:1 or greater; (B) the Apartment Complex has achieved 100% Qualified Occupancy, as determined by the Accountants; (C) Construction Completion has occurred and the mechanics lien filing period applicable to the Apartment Complex has expired; (D) the Investor Limited Partner has received and approved the Basis Certification and (E) the First Mortgage Loan has closed and funded and each Construction Loan has been fully repaid.

This is from another Investor

Operating Deficit Guaranty: The General Partner agrees to provide
unlimited operating deficit loans to the Partnership until all conditions of the Capital Contribution #3 have been satisfied. (Typically this will be stabilization) After the conditions of Capital Contribution #3 have been satisfied, (i) the Operating Reserve may be used to fund Operating Deficits (operating expenses, debt service obligations, or other expenses of the Partnership approved by the Investor Limited Partner), and (ii) the operating
deficit guarantee will be reduced to $TBD for at least 36-months. At the end of the 36-month period, the Operating Deficit Guaranty will be released, provided the Operating Reserves are fully funded in the amount of $TBD and the project averages 1.15 DSCR or better for the last 12 months of the 36-month period, or any subsequent 12-month period. The release criteria will be attested to, and documented by the Partnership Accountants, based on audited numbers, and delivered to Investor or its successors.

Repurchase Guarantee
This is the other significant guarantee that the town would be asked to take on. Repurchase is rare. Typically the circumstances that trigger repurchase are when the project is really floundering. I have never been part of deal that triggered a repurchase. As a consultant I review the items that would trigger repurchase and make sure all of them are reasonable and not something that might happen if the project was a little delayed or lease up was slow. As I say, repurchase means something really bad is happening with the project, the GP is not being responsive and the investor just wants out. Probably before they required repurchase they would replace the GP. None of this would not happen lightly or quickly. Below is an example of language from another deal.

Repurchase Obligation: The General Partner will be obligated to repurchase Investor’s interest in the Partnership should the project fail to meet certain legal and operational performance criteria as outlined below. The amount of the purchase price shall equal, as of the actual date of purchase, the sum of:
a) the aggregate amount of Capital Contributions and advances made by the Investor Limited Partner to the Partnership (less Credits allocated to the Investor Limited Partner prior to such purchase, but only to the extent that such Credits are not subject to recapture under the Code), plus b) an amount equal to 10% per annum thereon from the date of any Capital Contribution until the date of the Investor Limited Partner’s receipt of the Buyout Price, plus c) the legal, accounting and internal costs incurred by the Investor Limited Partner in connection with its investment in the Partnership (capped at $100,000), plus d) the amount of any interest and penalties imposed on the Investor Limited Partner as a result of such purchase or its prior claiming of Credits with respect to the Partnership, plus e) an amount that, on an After-Tax Basis, equals all transfer taxes or similar assessments incurred by the Investor Limited Partner in connection with its investment in the Partnership or the sale of its Interest pursuant to this Agreement, such amounts representing the parties’ good faith estimate of damages incurred by Investor.

Repurchase Obligation Criteria:
i. each Building is not placed in service on or before DATE CERTAIN, or, if earlier, the date required by any Lender or governmental agency;
ii. the Partnership fails to meet the minimum set-aside test, the rent restriction test of Code Section 42(g) within 12 months of the date that the Apartment Complex is placed in service, or any other requirement necessary for the Apartment Complex to qualify for Credits;

iii. the Apartment Complex has not achieved occupancy by Qualified Tenants of at least 90% of its low-income set-aside units by Date certain or the Partnership fails to qualify for at least 70% of the projected Credits in any year after the first year in the Credit Period;

iv. the Partnership has not achieved both Project Breakeven for 90 consecutive days and Permanent Loan Conversion by Date certain, or, if earlier, the maturity date of the construction loan, or if prior thereto a commitment for any Partnership loan is cancelled, withdrawn or substantially modified without the Consent of the Investor Limited Partner and a commitment for replacement financing acceptable to the Investor Limited Partner in its reasonable discretion is not obtained;

v. prior to Construction Completion, any substantial damage to or destruction of the Apartment Complex shall occur and the applicable insurance proceeds shall not be made available by the Lender for the restoration of the Apartment Complex or shall not, in the reasonable opinion of the Investor Limited Partner, be sufficient to repair and restore the Apartment Complex in a manner that would qualify for the aggregate projected Credit allocable to the Investor Limited Partner or the Apartment Complex is not restored within 24 months following such casualty;

vi. prior to Construction Completion, there shall have occurred an Abandonment; For purposes of this Agreement, “Abandonment” means the complete abandonment of the Apartment Complex such that all work by all contractors, subcontractors, materialmen, suppliers and any other tradespersons performing any work and supplying any materials or supplies for the Apartment Complex shall have ceased for at least 45 days.

vii. prior to the making of the Final Installment, a foreclosure action is commenced against the Apartment Complex and not dismissed within 45 days;

viii. the Partnership fails to receive the approval of the Investor Limited Partner’s admission into the Partnership from any lender or governmental agency (whose approval is required) within 60 days of the Admission Date; the Partnership fails to receive a Valid Carryover on or before due date.

Removal of a General Partner- this can happen but not often.

(a) The Special Limited Partner shall have the right to remove a General Partner and elect or appoint a new General Partner (i) on the basis of the General Partner’s performance constituting fraud, bad faith, misconduct, gross negligence or breach of fiduciary duty, or (ii) upon the occurrence of any of the following: (A) such General Partner shall have violated any material provisions of any Project Document or other document required in connection with any Mortgage and shall not have cured such violation within applicable grace periods, if any; (B) such General Partner shall have violated, and not cured (or, with respect to nonmonetary violations, not undertaken reasonable actions to commence to cure) within seven days after notice from
the Investor Limited Partner, any provision of this Agreement, including, but not limited to, any of its representations and covenants in Article VI or any obligation to provide funds under Sections 3.05, 6.10 and 6.11; (C) any Mortgage shall have gone into default and not been cured within any applicable cure period provided therein unless the default is waived by the Lender; (D) an Event of Bankruptcy shall have occurred with respect to the Partnership, the Guarantor or the General Partner or there shall be a default under the Guaranty; (E) such General Partner shall have failed to obtain a Title Policy in a form acceptable to the Investor Limited Partner pursuant to Section 6.09(j) of this Agreement or shall fail to obtain a date down endorsement of the Title Policy as required in the definition of Construction Completion; (F) the Partnership fails to maintain an Expense Coverage Ratio of 1.15:1, after taking into account any Operating Deficit Loans (such determination to be made on a quarterly basis); (G) the First Mortgage Loan has not closed and funded by the maturity date of the Construction Loans; (H) such General Partner shall have conducted its own affairs or the affairs of the Partnership in such a manner as would (x) cause the termination of the Partnership for federal income tax purpose; (y) cause the Partnership to be treated for federal income tax purposes as an association taxable as a corporation; or (I) in the event that any Affiliate of the General Partner providing services to the Partnership commits either (a) fraud, bad faith, willful misconduct or a breach of fiduciary duty in its performance or (b) gross negligence or violates any material provision of any Project Document or other document required in connection with any Mortgage and shall not have cured such violation within applicable grace periods, if any.

EXIT from the Partnership – See chart from SB Clark which is really helpful I think

At the end of the initial compliance period, 15 years, the investor will have received all their benefits and will want to exit the partnership. This is when the town would be in a position to take ownership of the development. Typically the investor is not looking for cash out of this exit. They want to make sure any of their liabilities are covered. If the deal creates a tax liability or did not deliver the anticipated credits, the investor will want to be made whole. The GP can mitigate those issues by underwriting the deal at the beginning with an eye on the capital account and keeping an eye on the capital account during the course of the 15 years period. In very simple terms the capital account is its funded with the full amount of the initial equity and then annually its reduced by the taxable losses on the deal (these are NOT operating losses but losses generated by loaning soft funds into the project, depreciation etc.) I don’t want to get too in the weeds on this but am glad to provide more detail on this if needed. Practically, we would upfront structure the deal with the investor so that they would exit with their liabilities covered but no cash. The town would then refinance the existing debt or could choose to re-syndicate the credits if the property needed rehabilitation.
EXIT OPTIONS (Language from other deals)

Purchase Option: Following the 15-year compliance period, the Investor Limited Partner shall have a put right, exercised by giving written notice to the Partnership within one hundred eighty (180) days following the end of the compliance period, to require the Partnership to redeem the interest of the Investor Limited Partner for a redemption price of $100 plus any amounts owed to the Investor Limited Partner by the Partnership and the Partnership shall promptly so redeem such interest.

The Limited Partner will provide the Nonprofit, a “qualified non-profit corporation” as such term is defined in Section 42(h)(5)(C) of the Internal Revenue Code, a right of first refusal to acquire the Property at the expiration of the 15-year tax credit compliance period. The purchase price for the Property with respect to the exercise of the right of first refusal shall be equal to the greater of (a) $100; or (b) the sum of (i) the principal amount of all outstanding indebtedness secured by the Property (including any accrued interest and any loans to the Partnership by a Partner), plus (ii) all federal, state, and local income taxes payable by the Partners attributable to such sale, plus (iii) an amount sufficient to enable the Partnership to distribute cash to the Limited Partners pursuant to the liquidation provisions of the Partnership Agreement in an amount equal to the sum of (A) its share of taxes in item (ii) above, plus (B) the amount, if any, of unpaid Credit adjustment payments owed the Investor Limited Partner, plus (C) the amount, if any, owed to the Investor Limited Partner under any other provision of the Partnership Agreement, plus (D) any federal, state and local taxes owed by the Investor Limited Partner as a result of its receipt of the cash distribution.

Sale or refinance

Upon sale of the Project and repayment of underlying financing or a refinancing of the permanent loan, proceeds will be allocated in accordance with the following order of priority:

1. Expenses of the sale and/or refinance and satisfaction of underlying financing plus any other third-party obligations and debts;
2. Payment of an amount equal to any tax credit shortfall;
3. Payment of any accrued fees, advances made by Investor and unpaid Asset Management Fee due Investor;
4. Payment of outstanding balance of any Operating Deficit Loans;
5. To repay the Subordinate Loan;
6. To payment of any outstanding principal and interest on the soft loans made by Sponsor or the GP;
7. 49% to the GP and 51% to the LP.

For a period of 24 months beginning at the end of the Section 42 Tax Credit compliance the GP shall have the option to purchase the Project for a price equal to the greater of (a) the Project’s fair market value or (b) the sum of all Partnership debt and liabilities plus LP’s exit taxes, if any, plus all payments due and owing to the LP under the terms of the Partnership (including tax credit shortfalls and recaptures and outstanding asset management fees) (the “Purchase Option”).

In addition, for a period of twenty-four (24) months after the expiration of the Section 42 Tax Credit compliance period, the GP or its designee which is a qualified non-profit entity shall have the Right of First Refusal to purchase the Project. The Right of First Refusal purchase price shall be equal to the sum of all Partnership debt and liabilities (including payment of LP loans) plus LP’s exit taxes, if any, plus all payments due and owing to the LP under the terms of the Partnership (including tax credit shortfalls and recaptures and outstanding asset management fees). The Purchase Option and Right of First Refusal shall terminate if the GP is removed from the Partnership.
A Brief Description of the Low Income Housing Tax Credit
The program was born in 1986 out of the changes in the tax code under Ronald Reagan.

Prior to 1986 investors in real estate could accelerate the depreciation schedule to increase tax losses.

The new tax code prohibited accelerated depreciation and only allowed straight line depreciation (typically 27.5 years for buildings).
The result:

- Congress had to find a way to incentivize individuals to invest in real estate that was affordable to renters.
- That incentive is a dollar for dollar tax credit for an investor in affordable housing.
- The Low Income Housing Tax Credit was born!
IRS Program in all 50 States

- Program is too large for the Treasury Department to manage
- Delegated the responsibility of managing the program to State Housing Finance Agencies (Colorado Housing and Finance Authority – CHFA)
How does the program work?

- Three Components
  - Rent Calculation (Income)
  - Debt
  - Equity
Setting the Rents

- Rents are typically set to be affordable to persons earning between 30-60% of the Area Median Income based on household size. A new rule called Income Averaging was implemented this year allowing for 20-80% AMI.

- A Utility Allowance is deducted from the Gross Rent to determine the Net Rent charged to the resident.
Tax credit projects typically have some form of debt

- Conventional debt
- Soft Loans (HOME Loans, CDBG, AHP Grants)
Tax Credit Equity is calculated two ways:
- The Basis Method – add all “good” costs and multiply by 9%
- The Equity Gap Method – Total Development Cost less debt and grants divided by 10 and then divided by the price the investor is paying for the tax credit.
- Cost Basis - Per unit Basis limits set by CHFA
- Must use the lesser of the 3 calculations
Why are the tax credits important?

CONVENTIONAL APARTMENT
- Typically 80% debt 20% Equity

TAX CREDIT APARTMENT
- Often 40% debt or less
The lower the debt on the property the less rent has to be charged to cover the mortgage payments.

In return for the tax credits and the additional equity that results, the owner signs a Land Use Restrictive Agreement (LURA) agreeing to keep the rents low for a 30-40 year period.

That is what makes it “Affordable Housing”.
The Ownership Structure

- Syndicator GP
- Investor LP - $$$
- The Investor/Syndicator - LP
- The General Partner
- Developer
- The Operating Partnership
- The Project
The Development Team

- Owner/Developer
- Investors/Syndicators
- Lenders
- Management Agent
- Attorney
- Accountant
- Engineers
- Architect
- General Contractor
- State Tax Credit Agency
The Investor/Syndicator’s Role
Produce Substantial Financial Contributions to build or rehabilitate the Project

The Investor/Syndicator’s Benefit
Tax Credits offset income tax due
Cash Flow Distributions
Tax Losses
Potential Sale or Refinancing Proceeds

How They Accomplish Their Goals
Require the General Partner and/or Developer to
Guarantee Delivery of Tax Credits Including a Lease-up Schedule
Guarantee Operating Deficits
Guarantee Completion of the Project
Guarantee Continuing compliance of the Project.
The Housing Finance Agency's Role

Allocate IRS Low Income Housing Tax Credits that are then sold to the Investor  LP/Syndicator
Potentially Allocate other Financing to the project

The Housing Finance Agency's Benefit

Decent, Safe, Affordable Housing as required by IRS Tax Code

How They Accomplish Their Goals

Monitor Tax Credit Compliance and Report any Deficiencies to the IRS
The GP or Developer’s Roles
- Apply for and obtain tax credits and other financing. Developer
- Provide Guarantees to the Investor LP to insure delivery of tax credits. GP
- Provide Guarantees to the Lenders to insure completion. GP
- Coordinate all Development Team Members. Developer
- Provide expertise to the General Partner in the development process, negotiate contracts, provide recommendations to General Partner, provide construction management, tax credit compliance, and asset management.

The Developer’s Benefit
- Developer Fee
- Potential Cash Flow - Asset Management Fee

How They Accomplish Their Goals
- Development Agreement between Owner/General Partner and Developer
Financial Overview

- Tax Credit properties are not cash flow driven
- Developer Fee driven
Mill Avenue Fraser Apartments
9% Low Income Housing Tax Credit (LIHTC) Family Housing

TBD Tax Credit Partnership LLC
LIHTC Partnership
Single Purpose Entity that Owns and Builds the Affordable Housing Project

TBD Tax Credit Investor Fund
Limited Partner
99.99% Interest

TBD Fund Manager
Possible Administrative Limited Partner (Syndicator)
0.001% Interest

TBD Town of Fraser Housing Authority Entity*
General Partner
0.009% Interest

TBD Developer LLC
Coordinates and Delivers on a Fee for Service Basis the Affordable Housing Project

Clark Lipscomb
Entity
Guarantor
Provides Construction Completion Guarantee and Adjuster Payments Resulting from Changes in Construction Schedule
75% Interest

Osprey Property Group, LLC
Jim Rawson
25% Interest

Development Agreement
Payment of fees and deferred developer fee

*By being a housing authority, the property receives property tax exemption under Colorado law. If the Town of Fraser does not create a housing authority, but wants to be the general partner, a housing authority partner may be added to the Tax Credit Partnership ownership structure as a special limited partner to achieve property tax exemption.

The general partner is assumed to provide operating deficit guarantee, tax credit guarantee, and manage the third-party manager with LIHTC experience who will most likely be employed, at least for the first few years of operations.

Would be responsible for adjuster payments resulting from delayed lease-up.
Option #1: Nonprofit Right of First Refusal

TBD Tax Credit Partnership LLC
LIHTC Partnership
99.99% Owned by Tax Credit Investor Limited Partner, 0.001% Owned by Fund Manager Limited Partner, 0.009% Owned by Town of Fraser Housing Authority General Partner

Sells Property to Housing Authority for assumption of debt and exit taxes, if any

Town of Fraser Housing Authority

Example Language:

The purchase price for the Property with respect to the exercise of the right of first refusal shall be equal to the greater of (a) $100; or (b) the sum of (i) the principal amount of all outstanding indebtedness secured by the Property (including any accrued interest and any loans to the Partnership by a Partner), plus (ii) all federal, state, and local income taxes payable by the Partners attributable to such sale, plus (iii) an amount sufficient to enable the Partnership to distribute cash to the Limited Partners pursuant to the liquidation provisions of the Partnership Agreement in an amount equal to the sum of (A) its share of taxes in item (ii) above, plus (B) the amount, if any, of unpaid Credit adjustment payments owed the Investor Limited Partner, plus (C) the amount, if any, owed to the Investor Limited Partner under any other provision of the Partnership Agreement, plus (D) any federal, state and local taxes owed by the Investor Limited Partner as a result of its receipt of the cash distribution.

Option #2: Purchase of Limited Partner Interests

TBD Tax Credit Partnership LLC
LIHTC Partnership
Single Purpose Entity that Owns and Builds the Affordable Housing Project

Purchases interests from Limited Partners for greater of debt and exit taxes, if any, and fair market value as restricted

TBD Tax Credit Investor Fund
Limited Partner
99.99% Interest

TBD Fund Manager
Possible Administrative Limited Partner (Syndicator)
0.001% Interest

TBD Town of Fraser Housing Authority Entity
General Partner
0.009% Interest

Example Language:

For a period of 24 months beginning at the end of the Section 42 Tax Credit compliance the GP shall have the option to purchase the Project for a price equal to the greater of (a) the Project’s fair market value or (b) the sum of all Partnership debt and liabilities plus LP’s exit taxes, if any, plus all payments due and owing to the LP under the terms of the Partnership (including tax credit shortfalls and recaptures and outstanding asset management fees) (the "Purchase Option").

Prepared by
S.H. Clark Companies
3-1-18 Version
ISSUES FOR NONPROFIT CORPORATIONS CONSIDERING PARTICIPATING IN LOW INCOME HOUSING TAX CREDIT PROJECTS

Introduction

1. This is a complex area of law with arcane rules and it is not possible here to delve into the more technical legal aspects of using the LIHTC Program. What we are attempting to do is to explain the various roles to be played in a LIHTC project, the benefits to participation in such a project, the risks inherent in such participation, what a nonprofit (“NP”) should consider in choosing whether and how to participate in a LIHTC project and how to structure nonprofit participation.

2. For the sake of this discussion we will assume that you (the audience or reader) have a basic understanding of the LIHTC Program and how it creates funding for low income housing.

3. While the LLC format can be used, this discussion assumes that the LIHTC project will be owned, as is usually the case, by a limited partnership. A limited partnership is a legally recognized entity established under the guidelines of state law consisting of one or more limited partners and one or more general partners. Limited partnerships are pass through entities, which means that the benefits and risks pass through to the partners as allocated in the partnership agreement.

Roles In LIHTC Project Development and Operation - Who Does What?

1. **Limited Partner(s)** - invests money, controls terms of partnership agreement, gets limited control of design and structure of project as condition to making investment (i.e. only makes investment if satisfied with design and structure of project) and cannot be involved in management and day-to-day decision making of partnership.

   1. **advantages** - usually gets 99 - 99.99% of tax credits, losses and cash flow, and a portion of residual value; liability limited to money invested.
   2. **disadvantages** - limited control of project, especially after initial closing.

---

1 This outline was written by Mark E. Levin, Chief Counsel of Regional Housing Legal Services. RHLS is a statewide tax exempt nonprofit corporation which provides legal and technical assistance to nonprofit corporations producing low income housing or carrying out economic development projects for low income communities. In that capacity RHLS has participated in over fifty LIHTC projects.
2. **General Partner(s)** - responsible for carrying out purposes of the partnership and making day-to-day decisions, overall management and control of the business, assets and affairs of the partnership, ensures compliance with requirements of LIHTC program and financing documents, supervises management agent and may invest in project (some projects require investment by general partner).

   1. **Advantages** - power to make decisions for partnership - hiring, budgets, contracting, management, landlord-tenant issues; often given right to purchase property after compliance period at nominal cost (this right is often extended to affiliates of GP or sponsor).
   
   2. **Disadvantages** - unlimited liability, obligation to make up difference between anticipated and actual tax benefits to LP (if tax benefits are reduced the limited partner may reduce its capital contribution and the GP will have the obligation to provide the funds necessary to meet project costs which were to be met with the withheld/repaid capital contribution), obligation to make cash flow loans, ensure completion of project, obligation to purchase limited partnership interests under certain conditions, environmental indemnification, tax credit compliance responsibility, reporting to investors and funders.

3. **Developer** - Responsible for putting together and overseeing work of development team (architect, contractor, accountant, lawyer, consultant, management agent), getting site control, obtaining all necessary governmental approvals, obtaining necessary funding, negotiating financing documents, determining design and scope of construction, negotiating and enforcing contracts and ensuring construction completed in good and worker-like manner, on time and within budget. The same party usually serves as developer and sponsor.

   1. **Advantages** - earns developer’s fee, primary control of all aspects of project design and development, liability limited to potential loss of part of fee but no partnership liability or money at risk.
   
   2. **Disadvantages** - only downside, if it can be called that, is that developer is largely responsible for success or failure of project.

4. **Sponsor/Guarantor** - Since these partnerships are usually established with a general partner with very limited assets and significant financial obligations, the sponsor must guarantee payment of the general partner’s obligations. Where NP serves as sponsor it usually also serves as developer and in return gets a developer’s fee, thus mitigating the disadvantage of financial obligations. Note that when the NP serves as guarantor it should also at least nominally serve as developer even if it actually hires one or more consultants to serve that function. In that way it will generate developer fee “income” to put at risk providing those guaranties and thus, at least in IRS’ eyes not put charitable assets at risk.

5. **Management Agent** - Responsible for renting and maintaining units, ensuring units rented to households with appropriate incomes (requirements of tax credit program - project must have minimum of either 20% of occupant households with incomes 50% of median household income for “area” or less or 40% of occupant households below 60% of median and all households residing in units for which tax credits obtained must not have incomes exceeding 60% of median; in order to compete for tax credits applicants often promise to put aside a certain number
of units for households at 20%, 40% and/or 50% of area median income; other funding sources may have other income requirements), drafting annual operating budgets, enforcing leases, evictions, paying mortgage(s) and all bills out of operating income, keeping financial records and collecting rents. Gets fee equal to 6-10% of gross income.

6. **Special Limited Partner** - Serves a special role in project - e.g. provides political muscle necessary to get required approvals and/or funding, serves as nonprofit necessary for competing for tax credits, lends reputation or stamp of approval to project/developer. In return special limited partner gets a share of the developer’s fee and/or some say in design of project or selection of tenants. Investors often have an affiliate corporation serve as a special limited partner to provide oversight of the project.

7. **Lender** - NP can raise money for the project from foundation and governmental sources and lend it to the partnership. Such funds are normally provided as deferred payment mortgage loans and can provide a means for a certain level of oversight regarding project operations.

**What Should Nonprofit Consider Before Deciding How It Will Participate In LIHTC Project?**

1. **What benefit(s) does the NP want out of the project?** - create the low income units, fix up neighborhood, money, selection of tenants, degree of control of the development process, degree of control of partnership management issues, degree of control of rental management issues, gain reputation as a developer of multifamily housing, learn how to do this type of development.

2. **What risks/burdens is the NP willing to bear?** - financial, having to ensure long-term compliance, reporting requirements, reputation if project fails, tax exempt status.

3. **What are the NP’s strengths and weaknesses?** - does it have the staff and experience necessary to fill developer or management agent roles, does it have financial strength necessary to serve as sponsor, does it have political strength necessary to obtain necessary approvals and financing, what is its development experience and reputation, does it have means necessary to pay for predevelopment costs, does it have ability to negotiate investor participation or access to appropriate consultant.

4. **What are the NP’s goals?** - to be a developer of low income housing, to provide social services to low income people, to revitalize a particular community or property, to facilitate revitalization, to organize residents of a neighborhood in support of things that aid neighborhood and against those that harm neighborhood.

5. The answers to those questions will determine how the NP should participate in the LIHTC Project. For example: if it wants to raise unrestricted funding to help support the NP’s operating costs and has the requisite staff/experience then it should participate as a developer and sponsor; if it wants to control development and operating issues but it doesn’t have the staff or expertise to serve as the developer or management agent, it should participate as the general partner (through an affiliate corporation) and sponsor - assuming it is willing to take the financial risk; if it is primarily interested in selecting and working with the tenants it may want to just participate
as the management agent; if it just wants to see project built and has political muscle it may want to serve as a special limited partner.

**Ownership by the Nonprofit After the Compliance Period**

The Partnership Agreement may contain an option to purchase and a right of first refusal by the General Partner or its affiliates (i.e., its parent NP) to purchase the property at the end of the compliance period. Options are usually written for the greater of the fair market value of the property as low income housing or the statutory minimum purchase price. According to the statute, the purchase price the parties agree on as they enter into the partnership may not be less than the principal amount of any outstanding indebtedness secured by the building plus all federal, state, and local taxes attributable to the sale. A right of first refusal is generally written for the statutory minimum purchase price. At the time of acquisition, the purchase price is effectively reduced by any loans owed to the NP. Since some of the loans to the partnership are likely to be deferred payment loans from governmental agencies, the NP may be able to assume the loans, further reducing the acquisition price. As tax credit projects reach the end of their initial 15 year compliance periods, some investors are choosing to donate their limited partner interests to the qualified non-profit corporation rather than sell that interest under the option or right of first refusal.

**Conclusion**

The Low Income Housing Tax Credit program is the primary vehicle for the development of low income rental housing. If a nonprofit corporation wants to develop, or participate in the development of, such housing it should consider participating in a tax credit project. This is a legally complicated area and one into which no nonprofit, or for-profit for that matter, should venture without serious thought, adequate counsel, either experienced development staff or development consultant and a property manager with experience managing tax credit projects.