Year 15 Nonprofit Transition Strategies For LIHTC Properties

Enterprise Community Conference
Cleveland. Ohio
November 16, 2007

TABLE OF CONTENTS

Year 15 Nonprofit Transition Strategies For LIHTC Properties

SECTION A
Overview

OVERVIEW

ENTERPRISE: A LEADER IN THE LIHTC INDUSTRY

Enterprise Community Investment, Inc. (Enterprise) is a national leader in investment and development services for affordable housing and community revitalization efforts. Founded in 1984 as a socially motivated for-profit corporation, Enterprise's core business is syndicating tax credit equity investments through the federal Low-Income Housing Tax Credit (LIHTC) program. Enterprise took a lead role in the creation of the LIHTC program, and to date our investments are helping to build affordable homes in 45 states, Puerto Rico and the District of Columbia.

THE LIHTC PROGRAM

The federal LIHTC program was enacted in 1986 and provides tax incentives to encourage the private investment of capital for the development of decent, affordable rental housing. To receive the benefits of the LIHTC, the program requires owners of qualifying rental housing to maintain compliance with low-income occupancy requirements for a minimum of 15 years. Those projects that received their tax credit allocations after 1989 must continue to meet federal low-income occupancy requirements for an extended period (usually a minimum of 30 years).

ASSET MANAGEMENT EXPERTISE

Since 1986, Enterprise has utilized the Low-Income Housing Tax Credit—for which it was both advocate and pioneer—to finance affordable apartments and homes. Enterprise monitors the projects in its tax credit equity investments, focusing on real estate management, tax credit and lender compliance as well as financial and tax review. Enterprise proactively manages the proper allocation of tax losses and credits throughout its investors' ownership of the project. The asset management Enterprise provides to its investment projects not only adds value to the properties in the portfolio but is also a customary way for Enterprise to do business.

YEAR 15 EXPERIENCE

In addition to delivering oversight to a growing portfolio of housing investments, Enterprise also works with partners to transfer project ownership to the sponsor when the 15-year compliance period is complete. The first tax credit projects in which Enterprise-managed funds invested are currently reaching the end of the 15-year compliance period, and are now eligible to be sold. At this point in a LIHTC project's life cycle, the investor typically no longer has an economic interest in the investment, and would like to dispose of its investment in the project.

Beginning in 2002, Enterprise has worked with investors and sponsors on disposition strategies for LIHTC projects. These include multifamily, inner city scattered site, mixed-use, mixed-income and lease purchase projects. In most cases the investor's interest in the partnership was transferred to the nonprofit sponsor, following the expiration of the LIHTC compliance period. The exceptions involved lease purchase projects where the project was sold to the nonprofit sponsor, who in turn sold the homes to the residents and the partnership was dissolved. In a few cases the investor disposed of its investment prior to the expiration of the LIHTC compliance period (an early out), requiring disposition bonds. In addition to guiding Year 15 transactions with its own partners and sponsors, Enterprise also provides training, refinancing, resyndication, and consulting services to investors and developers with LIHTC properties reaching the end of the tax credit compliance period.

For more information about our products and services, contact:

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Enterprise Community Investment, Inc. is a leading provider of the development capital and expertise it takes to create decent, affordable homes and rebuild communities. Enterprise leverages low-income housing, new markets and historic rehabilitation tax credits; short- and long-term debt, and development services to capitalize projects that make a catalytic difference in communities. For over two decades, Enterprise has privately raised $7 billion in capital to finance affordable housing, create vital communities and help transform the lives of low-income Americans, particularly those at the lowest end of the economic scale. Currently, Enterprise is investing in communities at a rate of $1 billion a year. Visit www.enterprisecommunity.com to learn more about Enterprise's efforts to build communities and opportunity.

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YEAR 15 DISPOSITION STRATEGIES

WHO WE ARE

Enterprise Community Investment, Inc. (Enterprise) is a nationally recognized leader in addressing issues associated with the federal Low-Income Housing Tax Credit (LIHTC) program's post-compliance period (Year 15) transitions. Beginning in 2002, Enterprise has worked with investors and sponsors on disposition strategies for LIHTC projects. These include multifamily, inner-city scattered site, mixed-use, mixed-income and lease purchase projects.

DISPOSITION ALTERNATIVES

It has been Enterprise's intention from the initial structure and development of Enterprise funded projects that ownership of those projects sponsored by nonprofit entities would be transferred directly to the nonprofit sponsor immediately following the expiration of the 15-year compliance period. Typically, nonprofit ownership would ensure that these projects would be maintained as affordable housing over the long term, preventing the displacement of tenants or loss of housing affordability. But there may be circumstances whereby projects are sold to a third party after the end of the 15-year compliance period—without a loss of tax credits. Enterprise is staffed with seasoned tax professionals able to analyze the impact of exit taxes and, where desired, propose possible mitigation strategies.

ENTERPRISE'S YEAR 15 SERVICES FOR PARTNERS

Development of disposition plans: As projects near the end of the 15-year compliance period, Enterprise is working closely with its nonprofit partners to help develop their plans for the continued viability of each project, usually through its transfer to the nonprofit sponsor. To the extent possible, these plans will provide for long term preservation of affordable housing. As part of that effort, Enterprise is evaluating the financial, physical and tax aspects of each project, and advising our partners on viable options. As part of this analysis, Enterprise evaluates the tax impact of project dispositions in order to provide its investors and project sponsors with accurate projections, including the effect of Year 15 dispositions. Enterprise is well positioned to provide support to organizations beginning to address these issues, including disposition alternatives, as well as to facilitate the disposition of projects either on behalf of investors or sponsors of LIHTC projects.

Strategies: Enterprise is working closely with its sponsors to develop disposition plans for those projects in which Enterprise-managed funds invested, to ensure the continued viability of projects well into the future, as well as ensuring quality affordable housing for the residents. Following are strategies Enterprise is pursuing with its partners:

- After reaching agreement with the project sponsor on the disposition plan, Enterprise and the sponsor are implementing the necessary steps to complete the transfer of the project or the investor's partnership interest to the sponsor.
- For projects that are performing well and in good condition, sponsors are planning to continue operations as they were during the initial 15-year compliance period.
- In some cases, a refinance scenario is appropriate to raise funds for capital improvements to ensure the viability of the project for the foreseeable future.
- Other projects are being re-syndicated with new tax credits, which are used to raise funds for capital improvements and pay off debt, allowing projects to continue operations with more affordable rents.
- In a few instances, projects developed under a lease-purchase concept are being transferred to the low- and moderate-income tenants, helping to create stability in the project neighborhoods.

FOR PARTNERS, INVESTORS, AND OTHERS

Training: Since 2003, Enterprise has conducted numerous training sessions on the Year 15 disposition process. These trainings have been held at both Enterprise-sponsored events and various industry-related conferences. With professionals from various backgrounds—sponsors/general partners, investors, accountants, syndicators, lenders, developers and attorneys—in attendance, Enterprise provides in-depth expertise, guidance and tools on Year 15 transitions.

Re-syndication: Projects with recapitalization needs offer the opportunity for sponsors/developers to consider re-syndication. Enterprise will assist partners in facilitating the re-syndication process, from feasibility to completion, under the following conditions:

1) the project has recapitalization needs;

2) tax credits are determined to be a viable funding source given the particular State's QAP and alternative sources of funding;

3) the sponsor desires to pursue re-syndication to recapitalize the project; and

4) Enterprise decides to pursue the re-syndication opportunity.

Consulting: Enterprise is currently assisting organizations that invested directly in LIHTC projects in their disposition process after Year 15. Enterprise's services have included working with the sponsor on alternative disposition plans, analyzing tax impacts for the investor and managing the disposition process.

For more information about our products and services, contact:

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Year 15 Nonprofit Transition Strategies For LIHTC Properties

SECTION B
Presentation

Year 15: Nonprofit Transition Strategies for Expiring LIHTC Properties

Enterprise Community Conference

Cleveland, Ohio

November 16, 2007

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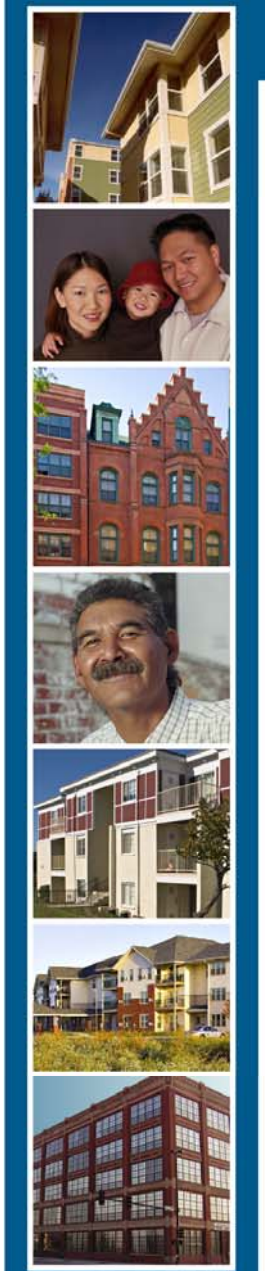

OBJECTIVES OF THE TRAINING

- Understand background on Year 15
- Discuss key issues
- Understand perspectives of stakeholders
- Learn how to develop an action plan
- Review Case Study

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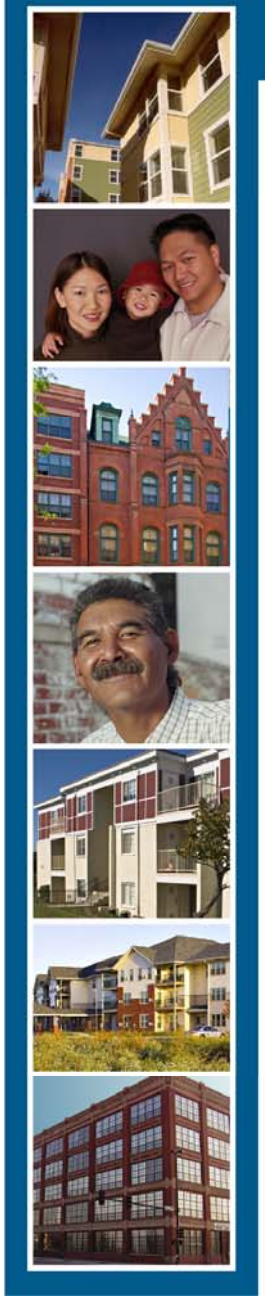

THE YEAR 15 PROCESS

- Step 1: Know the property
- Step 2: Know your partners and stakeholders
- Step 3: Know your documents
- Step 4: Develop your plan

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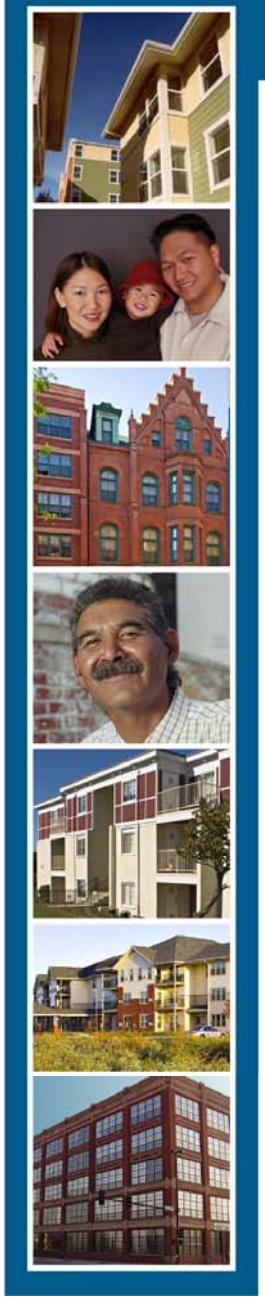

THE STAKEHOLDERS

- Residents
- General Partners/Sponsors/Developers
- Investors
- Syndicators
- Private Lenders
- Public Lenders
- Allocating Agencies
- The IRS

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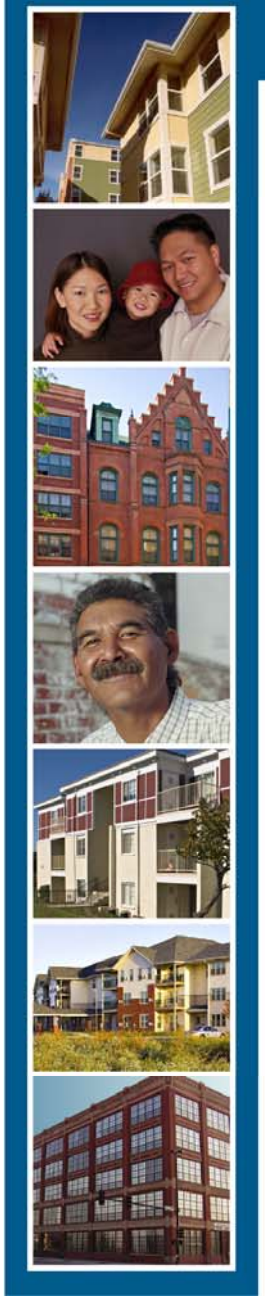

STRUCTURE OF LIHTC INVESTMENTS

- Investments are sold through Limited Partnerships and LLC's
- Partnership Agreements control dispositions, providing:
  - Transfer restrictions and price
  - Consent requirements
  - Distribution of Proceeds
  - Liquidation and Dissolution

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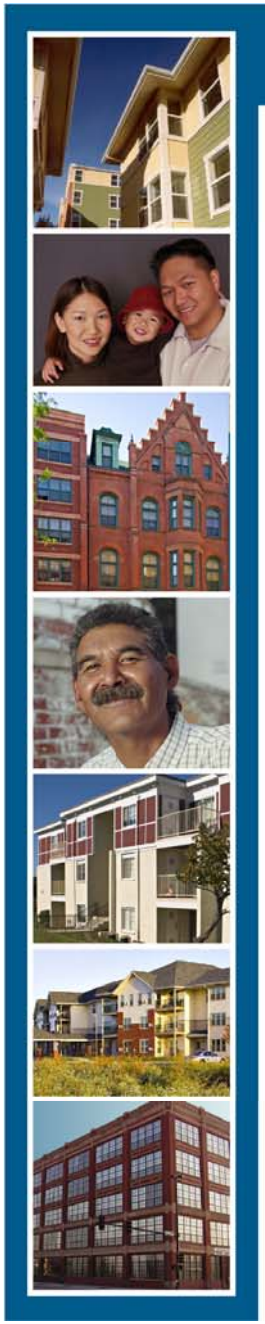

STRUCTURE OF LIHTC INVESTMENTS

Investor

$

Equity Fund

LP = Investor(s) 99.99%

GP = .01%

$

Project

LP = Equity Fund 99.99%

GP = Developer/Sponsor .01%

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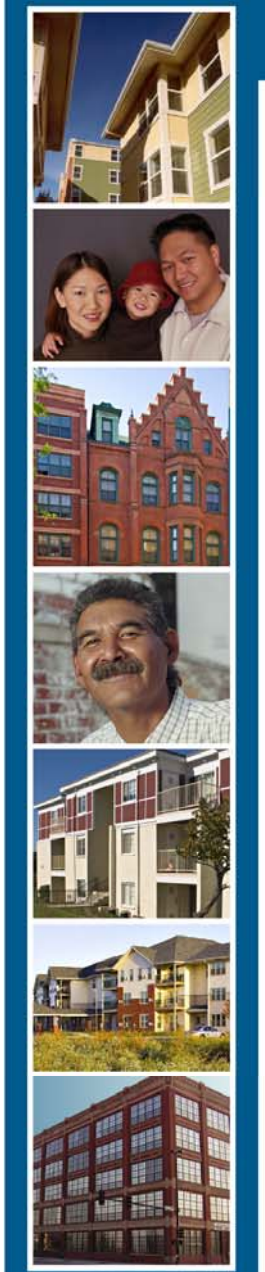

TYPES OF INVESTORS

Types of Investor vary:

- Direct Investors
- Syndicators (“Middlemen”)
  - Single Corporate Investor Funds
  - Multiple Corporate Investor Funds
  - Multiple Individual Investor Funds

Types of Syndicators vary:

- National for-profit
- National nonprofit
- Regional (mostly nonprofit**)**

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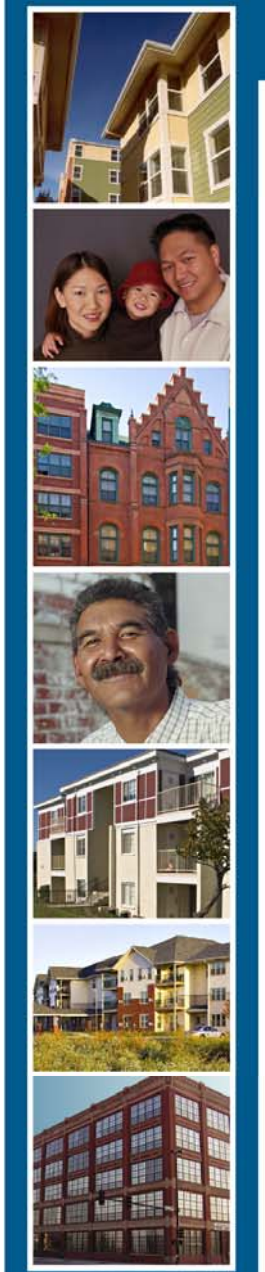

SIGNIFICANCE OF YEAR 15

Initial compliance period expires at the end of Year 15

- Can transfer ownership in year 16 without recapture
- Tax credit transactions are envisioned by investors as 15-year investments
- Most investors are ready to dispose of their interest in year 16

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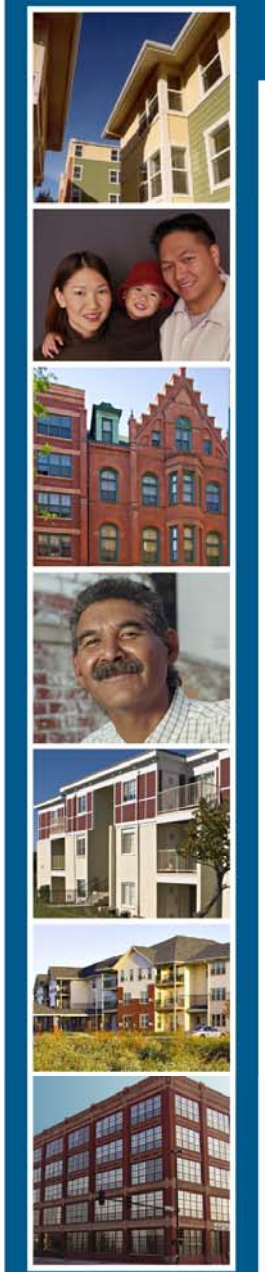

DETERMINING YEAR 15

- **Tax Credit Compliance for Each Building Begins:**
  - The first year tax credits are reported on tax returns for that building

- **Can be:**
  - The first year a qualified building is PIS or
  - The year after the building was PIS

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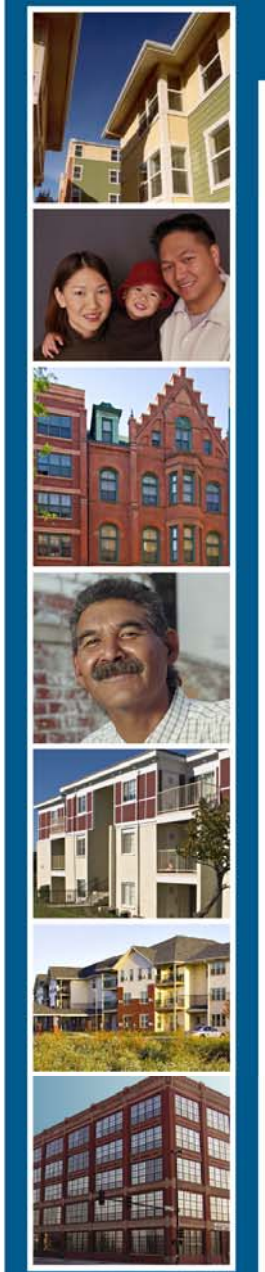

DETERMINING YEAR 15

- **Tax Credit Compliance Ends:**
  - The last day of the 15th year since credits were first taken
  - May be different for different buildings
  - Plan disposition in Year 16 for the <u>last</u> building placed in service

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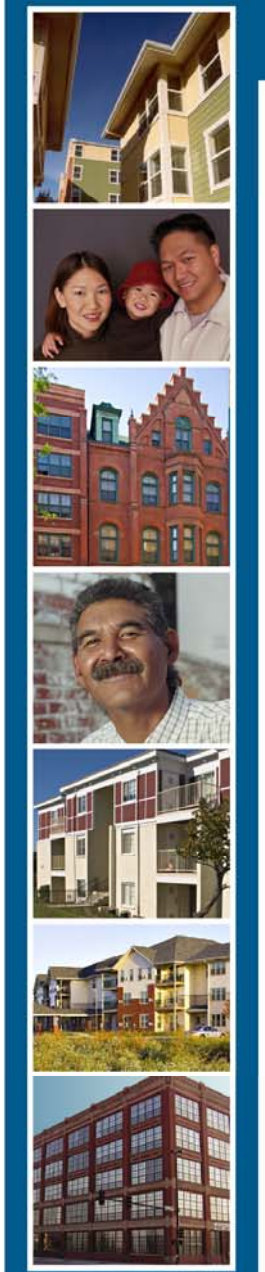

DETERMINING YEAR 15

Example:

- Tax Credits allocated in 1991
- Building Placed in Service (PIS) in 1992
- Elected to begin taking credits in 1992
- Tax Credit Compliance Period expires 12/31/06
- Year 15 is 2006
- Transfer ownership without recapture in 2007

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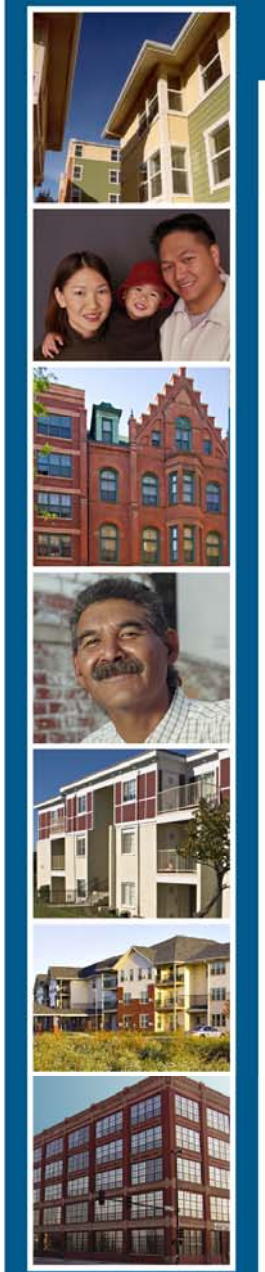

PURCHASE AND REUSE OPTIONS

Purchase of Real Estate or Investor's Interest:

- Sponsor Acquires
  - Continue Operations As Is
  - Rehabs through Resyndication and or Refinancing
  - Sells to Third Party
- Partnership Sells to Third Party
- Homeownership (Lease-Purchase)

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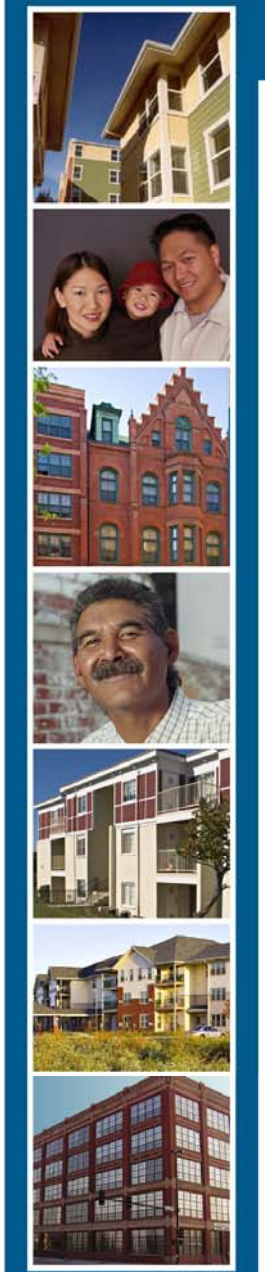

RESYNDICATION

- Makes sense where rehab is needed
- Minimum rehab:
  - 10% of acquisition cost or
  - $3,000 investment per low-income unit
- Structure to preserve Acquisition Credit
  - Problems if buyers and sellers are related parties
  - Related party means holding more than 10% interest prior to and after sale
  - Must comply with 10 year Look-back rule (exception for non-profit buyer)

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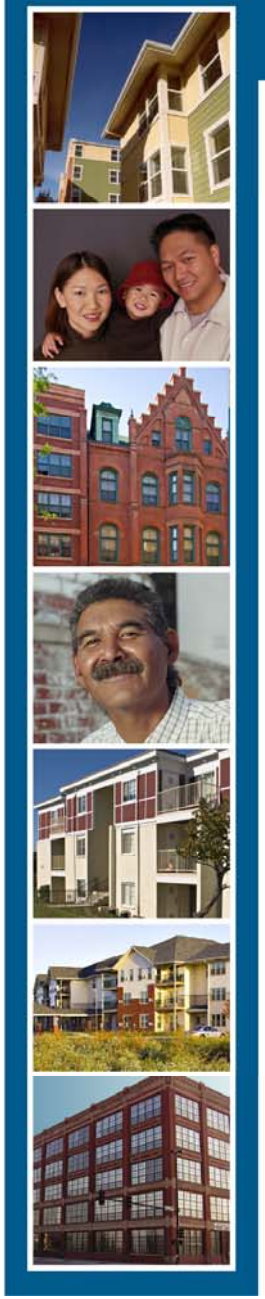

EXIT STRATEGIES: POSSIBLE SCENARIOS

- Right of First Refusal to purchase property
- Buyout option to purchase partnership interest
- “Puts”: Obligation to Purchase
- Qualified Contract
- Bargain Sale
- Sale to 3rd party
- Purchase within compliance period (“Early Exit”)

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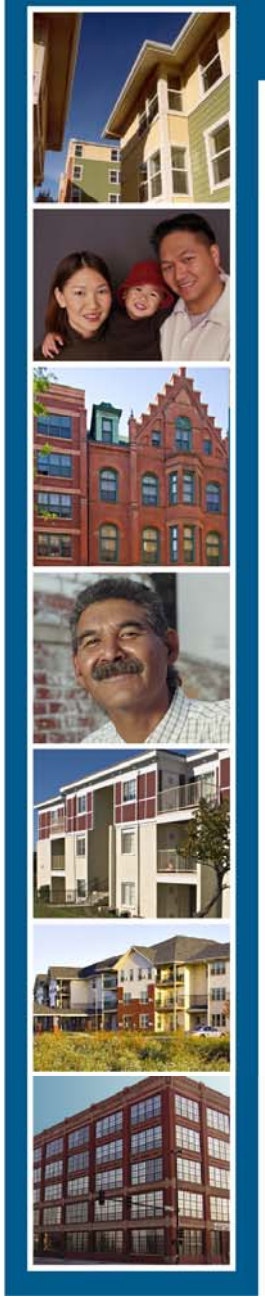

POST-1989 DEALS: RIGHT OF FIRST REFUSAL

- 1989 revision to Internal Revenue Code allowed the sale of LIHTC projects through Right of First Refusal to certain qualified groups at a bargain price
- Formula Price = Debt plus Exit Taxes (Parties may agree to add an adjuster for unpaid benefits)

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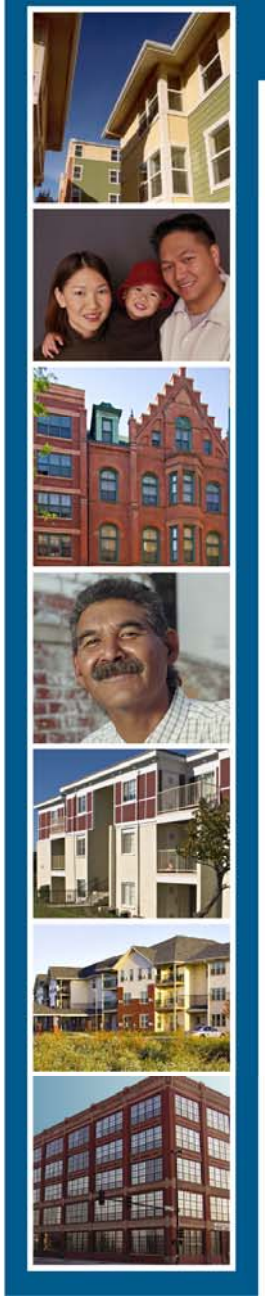

RIGHT OF FIRST REFUSAL

Formula Price is available to:

- Tenants
- Resident management corporations
- Qualified nonprofits
- Government agencies

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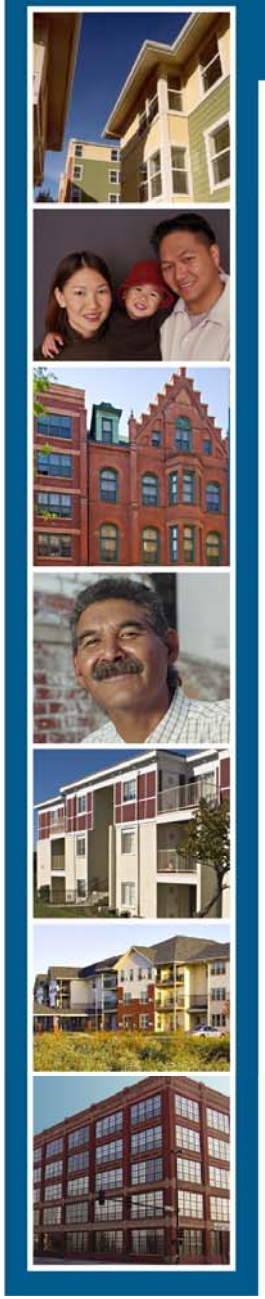

RIGHT OF FIRST REFUSAL

Issues with Right of First Refusal:

- Is a bona-fide 3rd party offer required?
- Reserves not included
- Transaction costs
- Formula Price may exceed fair market value

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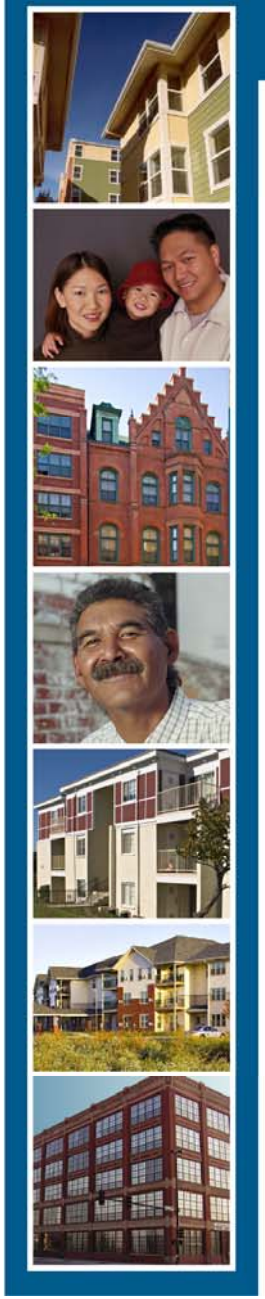

BUYOUT OPTION OF PARTNERSHIP INTEREST

Typically, option price is <u>greater of</u>:

- Fair Market Value of Partnership Interest

Or

- Unpaid Benefits plus Exit Taxes

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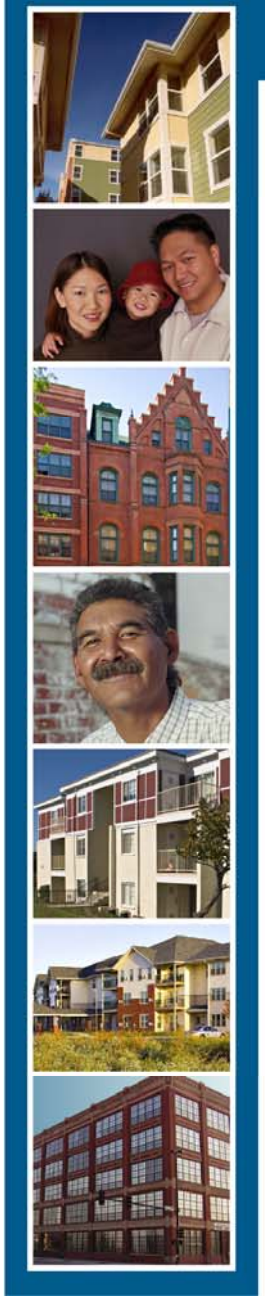

"PUTS": OBLIGATION TO PURCHASE

- Partnership Agreement may **obligate** the General Partner to purchase the property or partnership interest following expiration of the LIHTC compliance period
- Price or formula to determine price will be established up front

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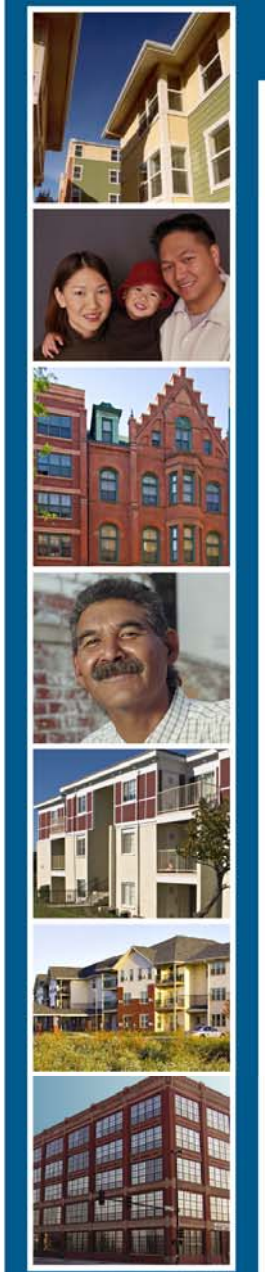

QUALIFIED CONTRACT

- 1989 revision to Internal Revenue Code added extended low income restriction
- Recorded as a restrictive covenant (LURA)
- Extended use expires the <u>later</u> of:
  - 15 years after the end of the compliance period
  - Date specified by the State
- Can be terminated only through:
  - Foreclosure
  - Qualified contract process

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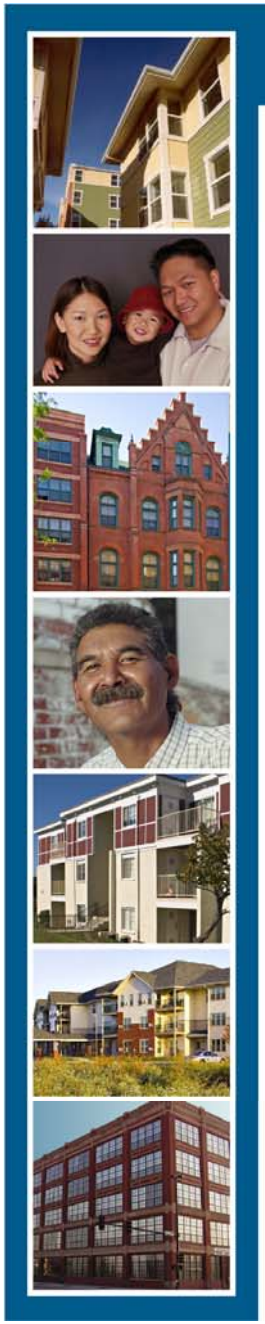

QUALIFIED CONTRACT

- So-called “Opt-out” provision
- Applicable to projects with post-1989 allocations with extended use restrictions
- Owner may submit a request to the Allocating Agency to sell the property
- State must locate a buyer at formula purchase price
- If buyer is not found within one year, extended use restrictions are TERMINATED

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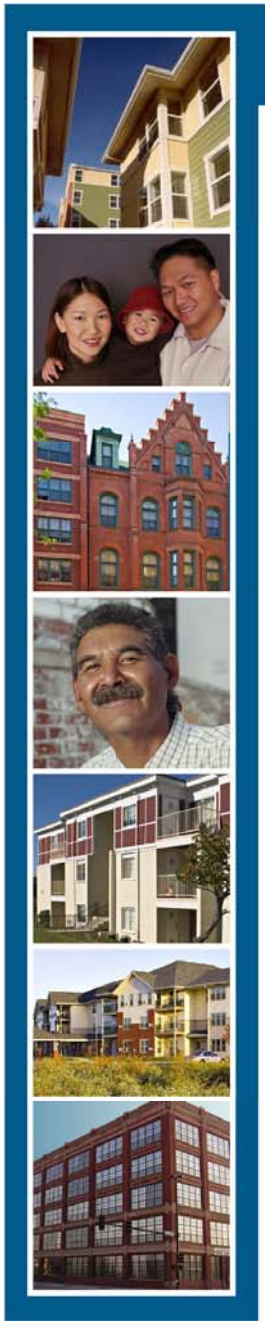

QUALIFIED CONTRACT

Qualified Price equals

- Outstanding debt secured by the property
- Plus capital invested adjusted by the Cost of Living Factor up to 5%
- Less any distributions and funds available for distribution

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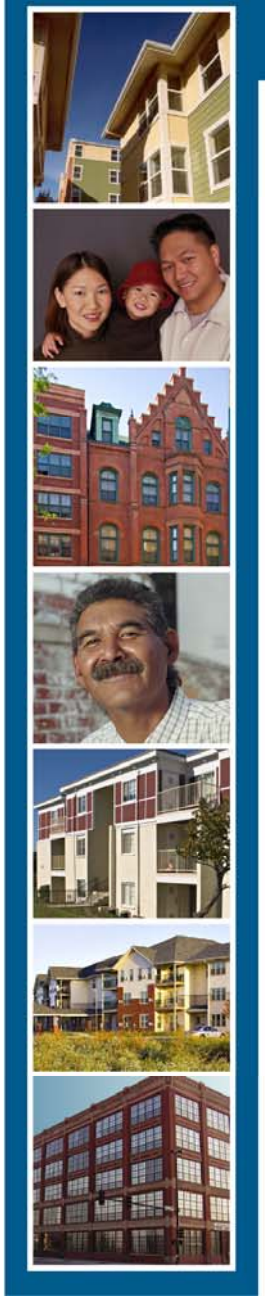

QUALIFIED CONTRACT

- States are issuing their own rules
- Some States restrict the “Opt Out” at the front end
- The industry is seeking a uniform approach
- IRS proposed guidelines

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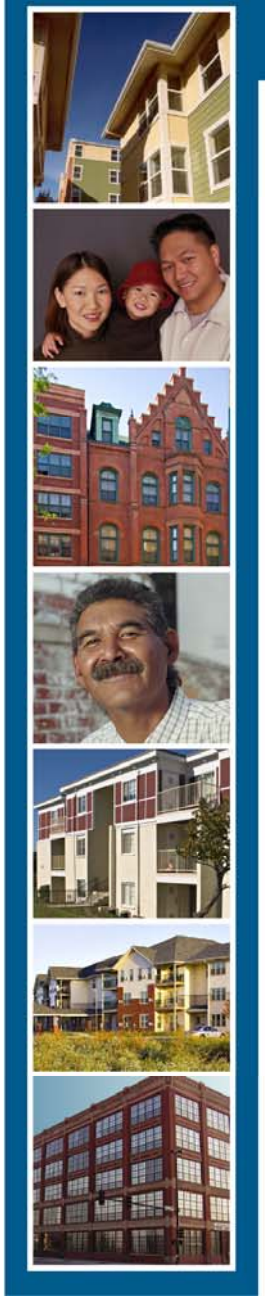
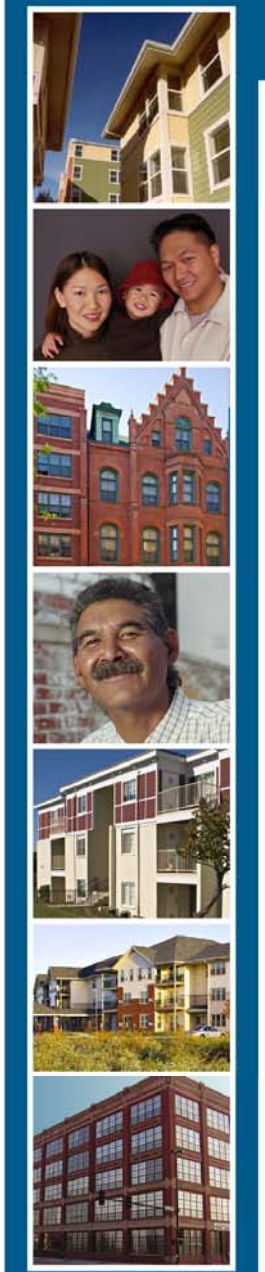


BARGAIN SALE

Concept: Part sale, part donation

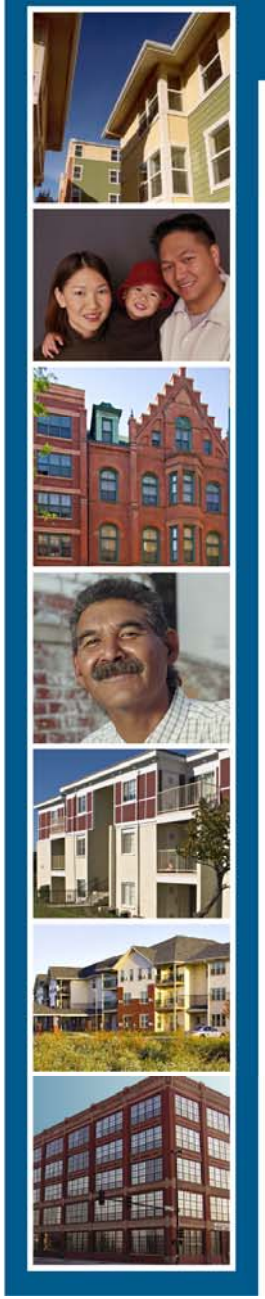
- Applies where market value of property exceeds amount of debt on property
- Will offset exit taxes for the Investor
- But: Investor may prefer cash proceeds



SALE TO THIRD PARTY

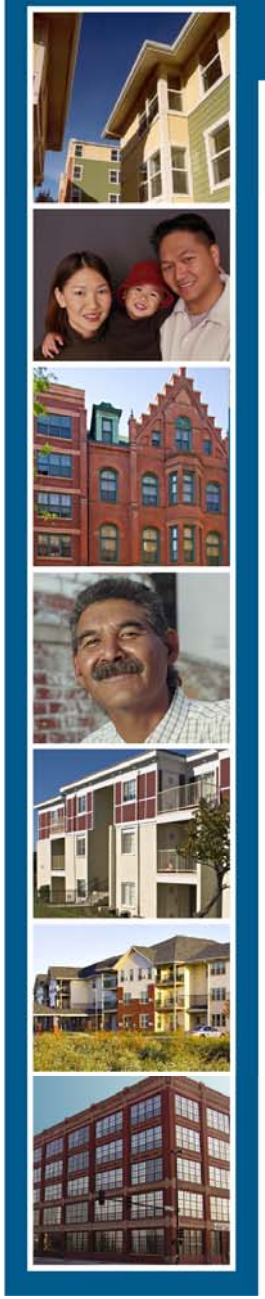
May occur when

- Investor and General Partner cannot come to terms
- General Partner does not exercise the Right of First Refusal or Buyout Option
- General Partner wants out of the project



EARLY EXIT

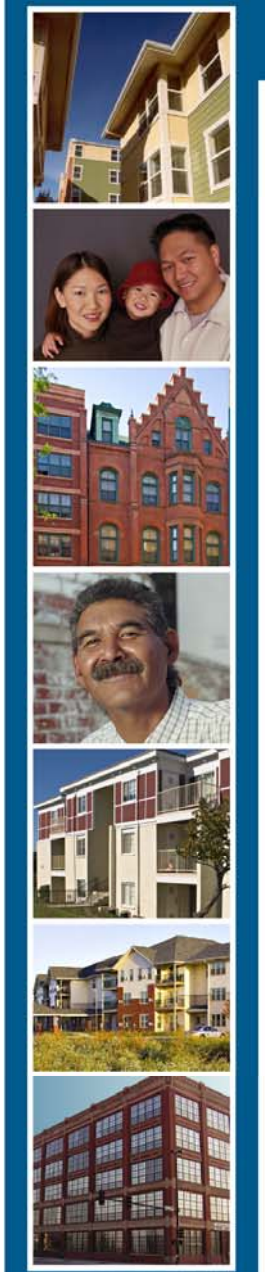
- Investor can dispose of its interest prior to Year 16, provided:
  - LIHTC compliance is maintained
  - Bond is posted for each investor
- Early outs are generally not feasible for multiple investor funds



EXIT TAXES

What is an "Exit Tax"?

- Cumulative tax losses exceed the investor's invested capital
- Result is a negative capital account
- Disposition results in a tax liability
- Need to be aware of book to tax differences on tax returns
- Also adjust for Historic Tax Credit (if applicable)



EXIT TAX EXAMPLE

- Limited Partner interest sold to General Partner in January 2007
- Sale price equals debt + exit taxes
- The capital account balance for the LP is ($500,000)
- LP's federal tax rate is 35%
- ($500,000 x 35%) = $175,000 exit tax
- Apply "gross up" factor: 1 + tax rate (1 + 35% = 1.35)
- Grossed up exit tax would be $236,250 ($175,000 X 1.35 = $236,250)

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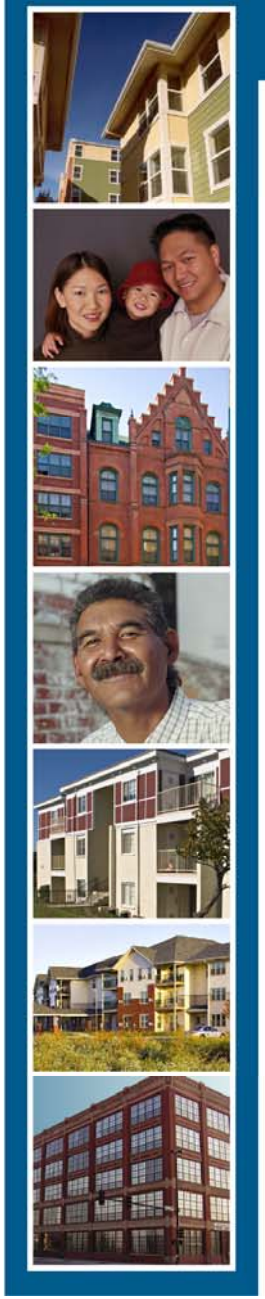

WAYS TO MANAGE EXIT TAXES

From years 11-15:

- Forgive debt
- Reduce LP interest by 1/3
- Freeze allocation of losses when required by tax code
- Relate qualified non-recourse debt and/or add security to debt
- Capitalize rather than expense repairs
- Improve operations

In year 16:

- Bargain Sale

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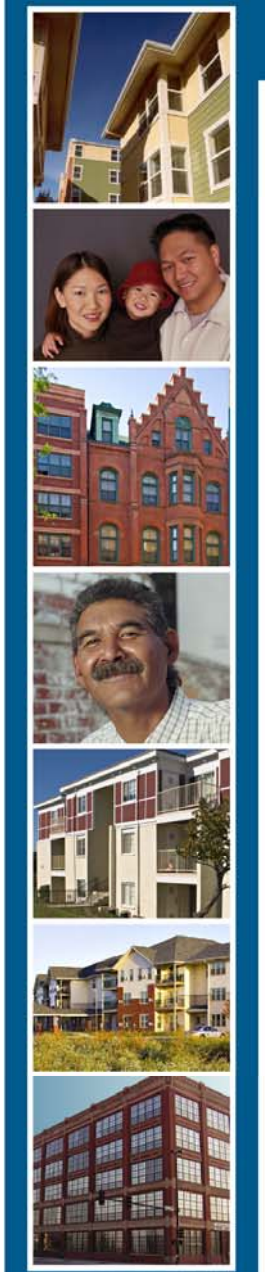
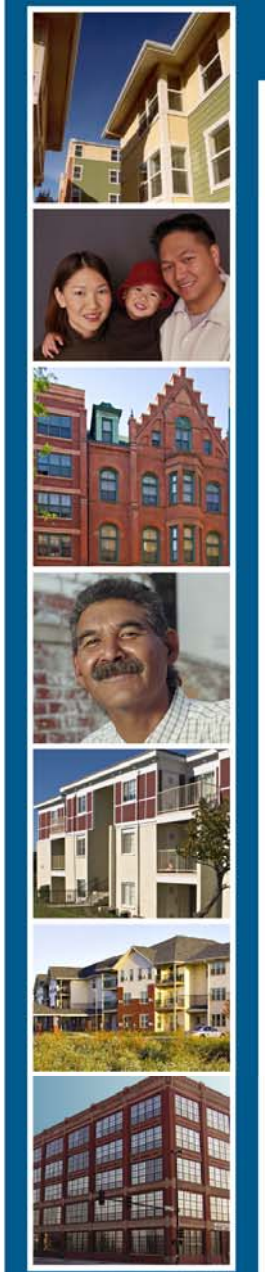


PROJECT/PARTNERSHIP ISSUES

- The GP Perspective
  - Does the GP have the desire and capacity to purchase the project?
- Investor Perspective
  - Is the Investor flexible with sale or transfer?
  - Were Investor benefits realized?
- Capital Account Balance
  - Are there exit taxes?
  - If so, are there sufficient funds to pay exit taxes?



PROJECT/PARTNERSHIP ISSUES

- Financial Condition
  - Will cash flow be sufficient to sustain future operations?
  - Are there any anticipated changes in the budget, such as loss of rental subsidies or tax abatements?
  - What are reserve balances and restrictions?
- Physical Condition
  - Are significant capital improvements needed?
  - Is there a current Capital Needs Assessment (CNA)?
- Market Conditions
  - Is the project marketable?
  - Is there competition from other projects?

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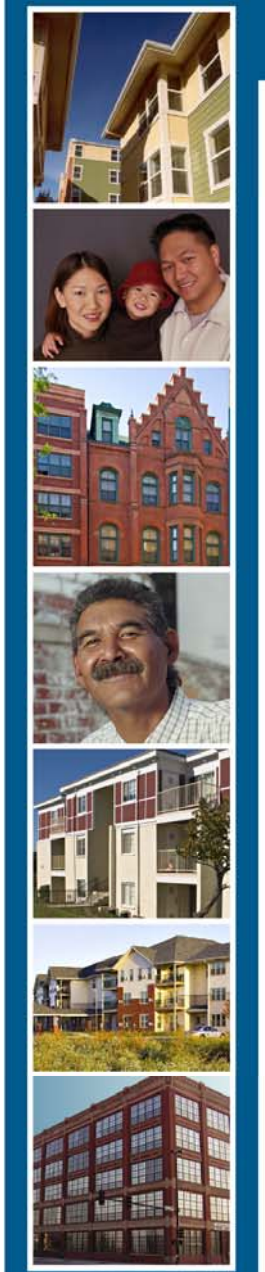

PROJECT/PARTNERSHIP ISSUES

- Mortgages
  - Are balloon loans or deferred interest payments due at or immediately after Year 15?
  - Does existing debt exceed fair market value?
  - Are lenders flexible with transfer of debt?
  - Can debt be refinanced or forgiven?
  - Are there sources for soft debt?

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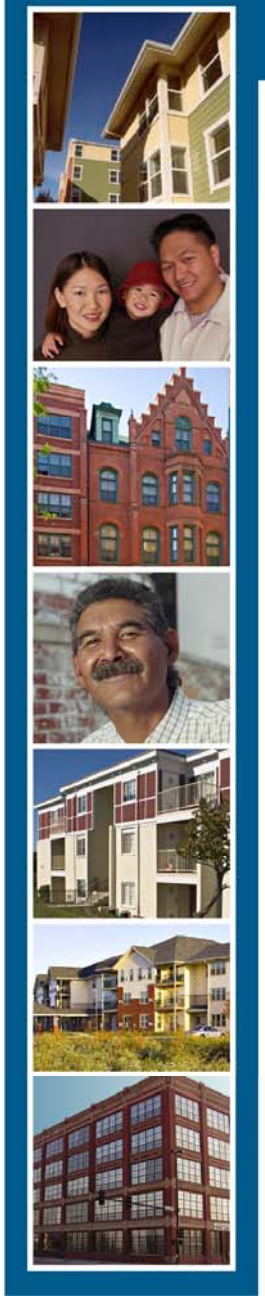

ACTION PLAN FOR PURCHASERS

YEARS 10-13:

- Determine when compliance period ends
- Review current performance and develop projections
- Review capital needs
- Review and project capital account and exit taxes
- Develop strategic plan:
  - Through Year 15
  - After Year 15

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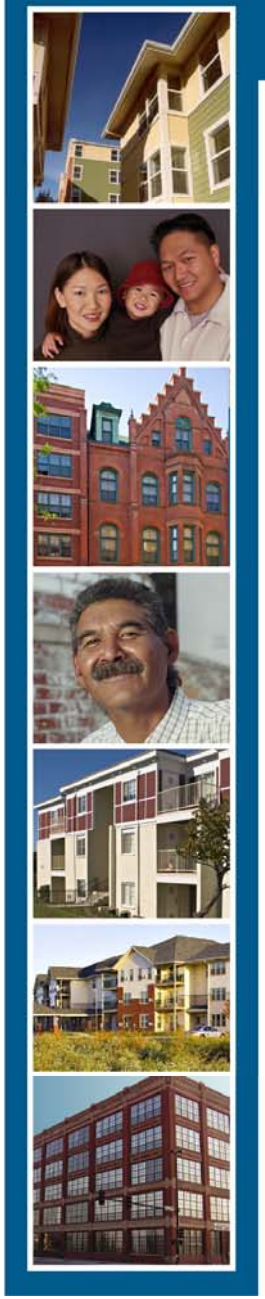

ACTION PLAN FOR PURCHASERS

YEARS 13-14:

- **Analyze Partnership Debt**:
  - Can loans be assumed, forgiven or restructured
  - Lender affordability restrictions
  - Lender approval rights

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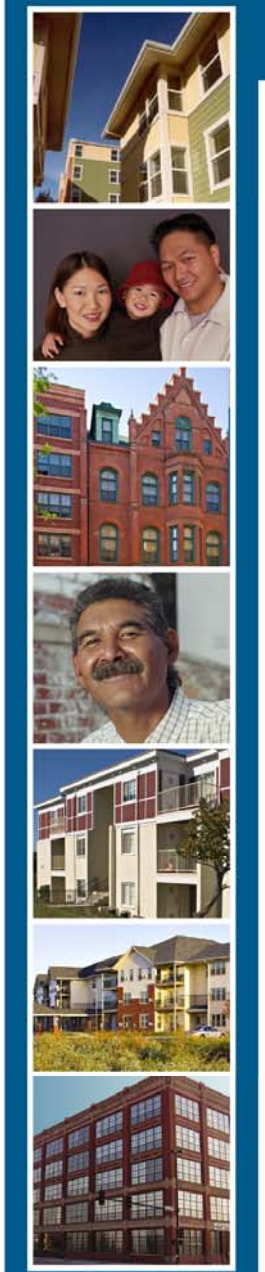

ACTION PLAN FOR PURCHASERS

YEAR 13-14:

- **Determine Likely Purchase Price**
  - Per Option or Right of First Refusal
  - Does the price make sense?
- **Explore Sources of Funds to Meet Purchase Price and Capital Needs:**
  - Resyndication
  - Refinance: Conventional debt or soft loans
  - Capital infusion
  - Reserves
  - Combinations

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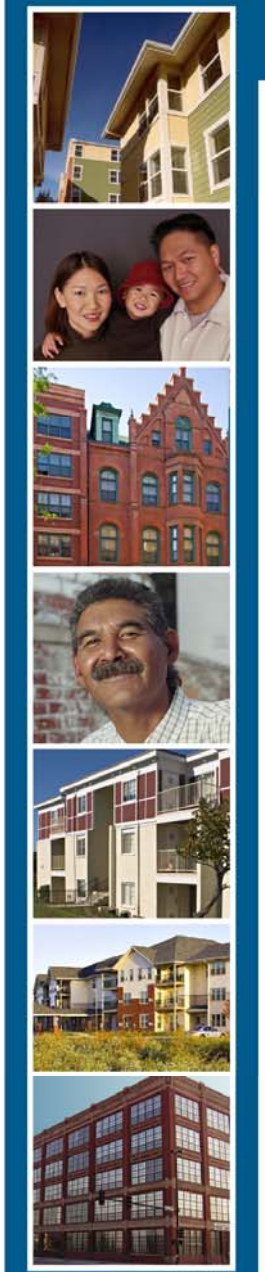

ACTION PLAN FOR PURCHASERS

YEARS 14-15:

- Consult with Accountant and Attorney
- Meet with Syndicator
- Negotiate Purchase Price
- Sign Letter of Intent
- Obtain Lender Approvals (if required)
- Draft Legal Agreements

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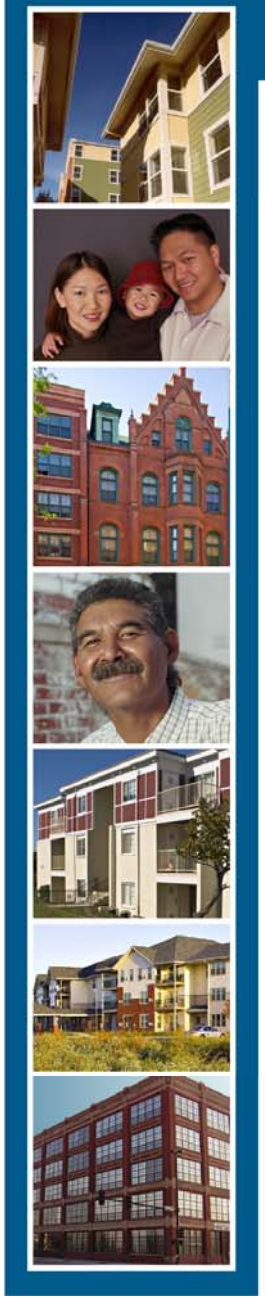

ACTION PLAN FOR PURCHASERS

YEAR 16:

- Close on purchase in 1st quarter of year 16
- File amended Certificate of Limited Partnership (if applicable)
- File tax return and provide final K-1 to Limited Partner(s)
- Execute an amendment to the Partnership Agreement, signed by withdrawing and new partners

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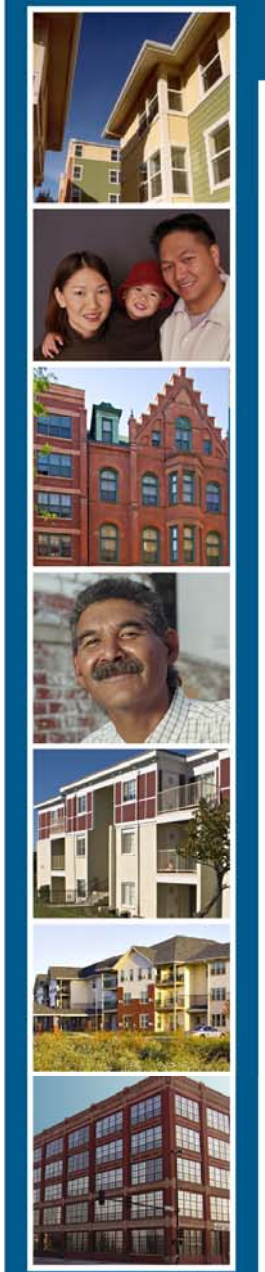

YEAR 1 – BACK TO THE FUTURE

- **Determine goals at the outset**
  - Financing can extend the restriction period
  - How long will rent subsidies last?
  - Ability to pay ballooning debt
  - Extent and durability of improvements
  - Clarify transfer provisions in pertinent documents
  - Review impact of state agencies scoring criteria
- **Structure and review projections**
- **Consider exit tax**
  - Slower depreciation elected or required
  - Source of funds for exit tax

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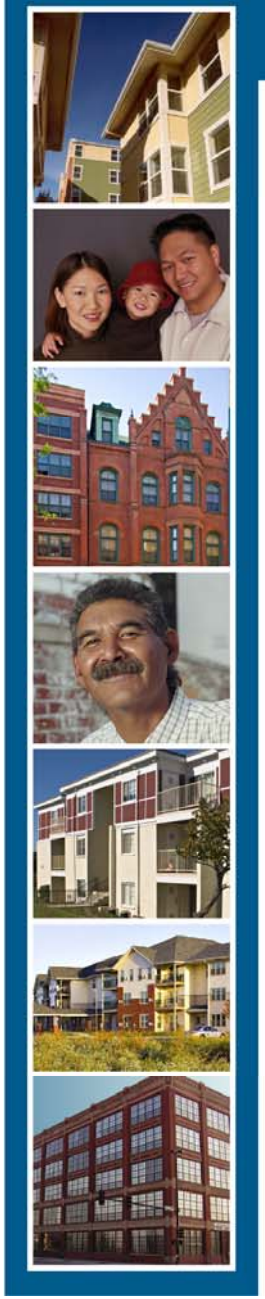

ENTERPRISE'S EXPERIENCE TO DATE

- **150 Projects transferred or approved through 10/31/07**
  - Lease purchase (Cleveland)
  - Early out
  - Consulting projects
  - Resyndication

- **2007-2009: approximately 168 pending**

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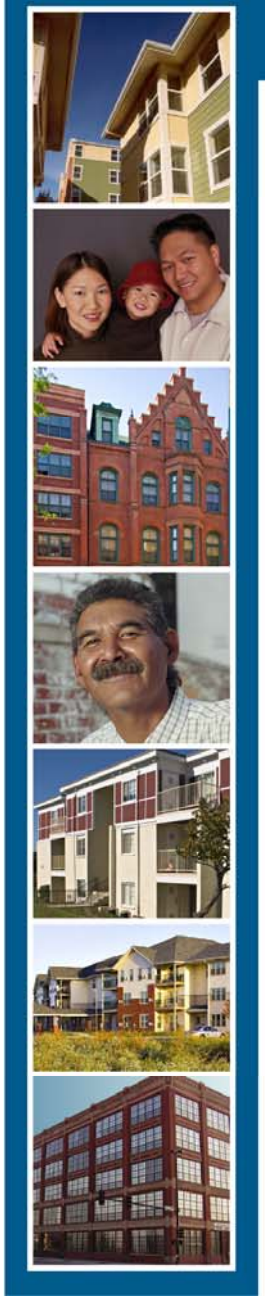

ENTERPRISE'S GOALS

- Deliver Expected Investor Return
- Transfer to Nonprofit Sponsors
- Preserve Affordability
- Minimize displacement of low-income residents
- Preserve Project Viability

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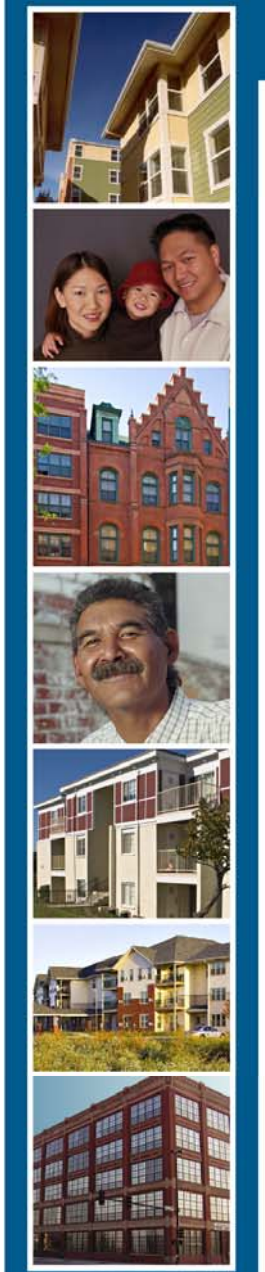

ENTERPRISE ROLES

- Enterprise has primary duty to ensure delivery of investors' return
- Will promote investor's goal to exit in year 16
- Works with the sponsor to develop its Year 15 transition plan
- Can provide equity to resyndicate the project with new tax credits
- Can provide debt to refinance the project
- Can provide consulting services to investors

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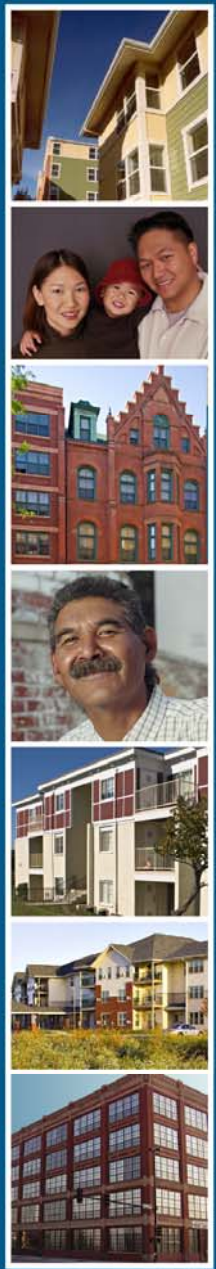

Housing Opportunity Limited Partnership

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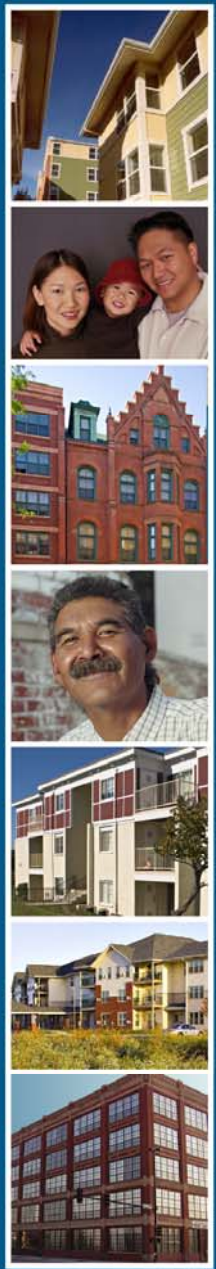

CASE STUDY

- Tax Credits allocated in 1991
- Placed in Service Date (PIS) 1992
- Elected to begin credit period in 1992
- Tax Credit Compliance Period Ends 2006
- Eligible for sale or transfer without recapture in 2007

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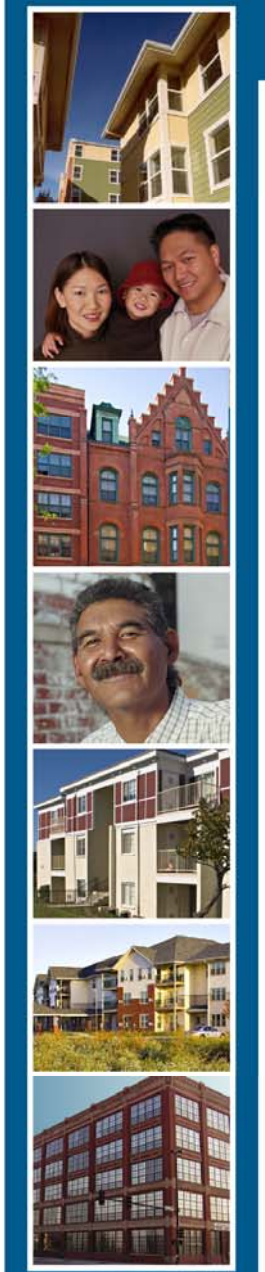

CASE STUDY

- 40 Units
- Existing Debt
  - First Mortgage (must pay) $700,000
  - City Loan (cash flow) 400,000
  - Total $1,100,000
- Reserves 300,000
- Capital Needs ($2,000/unit) 80,000
- Year 16 Projected NOI 80,000
  - $80,000/8% Cap Rate
- FMV of Property 1,000,000

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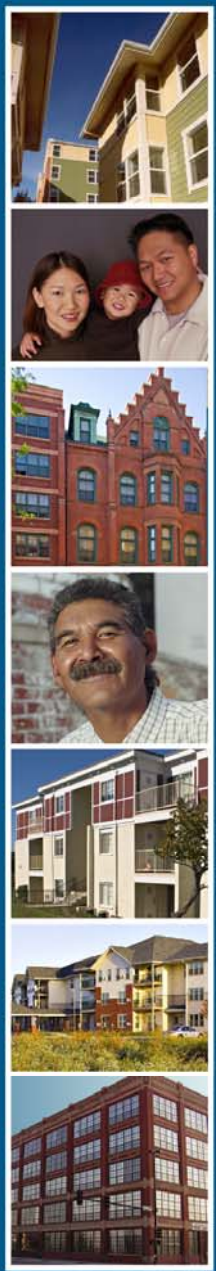
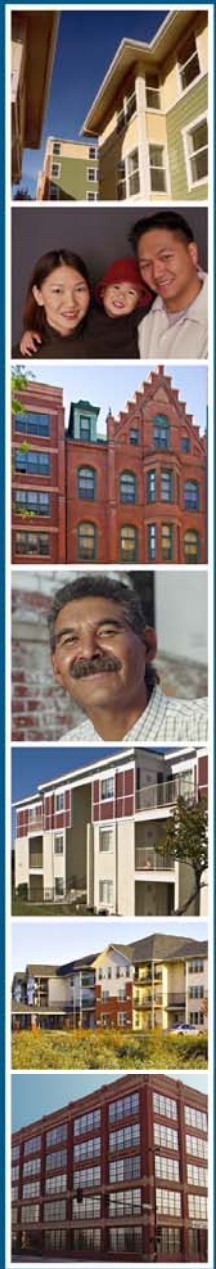


Non-profit sponsor holds:

- The right of first refusal to purchase the property for debt plus exit taxes, and
- An option to purchase the Investor's partnership interest for the greater of
  - Its Fair Market Value (FMV) or
  - The sum of unpaid benefits plus the Investor's exit tax



VALUE OF LP INTEREST:

▪ FMV of Property	$1,000,000
▪ Plus Reserves	300,000
▪ **Total:**	**$1,300,000**
▪ Minus Existing Debt	1,100,000
▪ FMV of Partnership	200,000
▪ FMV of LP Interest (x 99%)	$198,000

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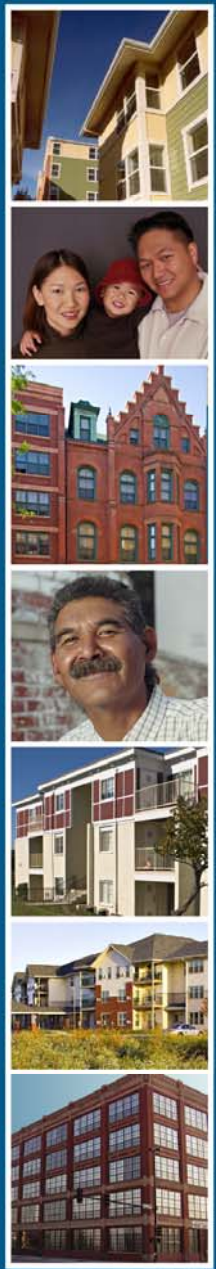

Exit Tax:

LP Capital Account Balance	(500,000)
▪ Tax Rate 35%	
▪ Exit Tax	175,000
▪ One Time Gross Up	X 1.35
▪ **Total Exit Tax**	**$236,250**

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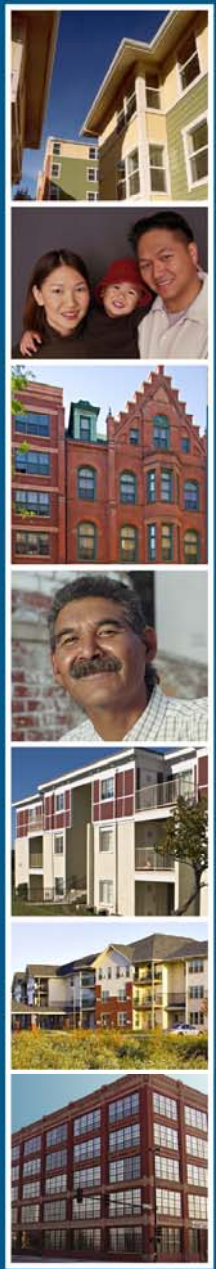

Option Price for Purchase of Investor's Partnership Interest

Greater of:

- FMV of Partnership Interest $198,000
- Unpaid benefits plus exit tax $236,250
- Option price $236,250

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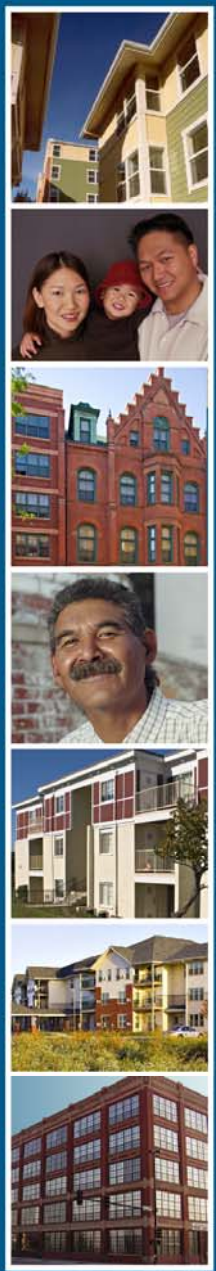


Purchase Price Recap

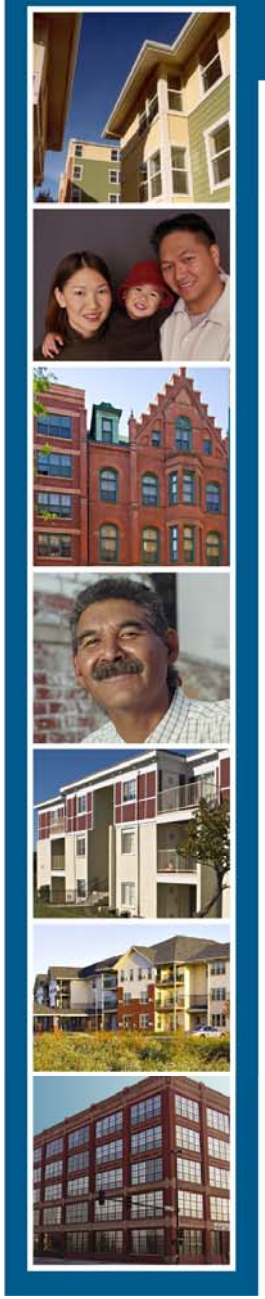
- Right of First Refusal:

Debt	$1,100,000
Exit Tax	236,250
Total	$1,336,250

- Purchase of LP's interest:

Cash	$236,250
Assumption of debt	$1,100,000
Total	$1,336,250

Which is preferable?



CASE STUDY

- **GP elects to purchase LP's interest**
- **Why?**
  - No change of title to property, therefore debt does not have to be assumed by a new owner
  - Fewer costs
    - May avoid transfer tax in some states
    - No recordation fee
    - Reduced legal expenses due to fewer documents i.e.; new deed not required
  - Reserves stay with the property

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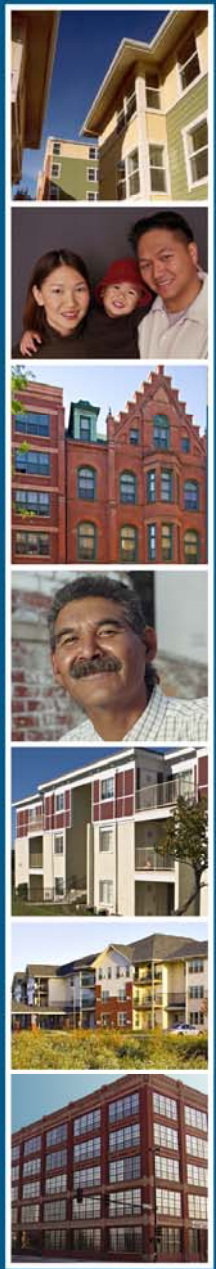

Refinance First Mortgage

- Year 16 NOI $80,000
- Available for Debt Service $69,565
  - ($80,000 / 1.15 DCR)
- New Mortgage
- Lesser of:
  - 7% rate, 30 year term $871,348
  - Loan to Value Ratio:
    - $1,000,000 FMV
      x80% LTV **$800,000**
    - **Maximum loan: $800,000**

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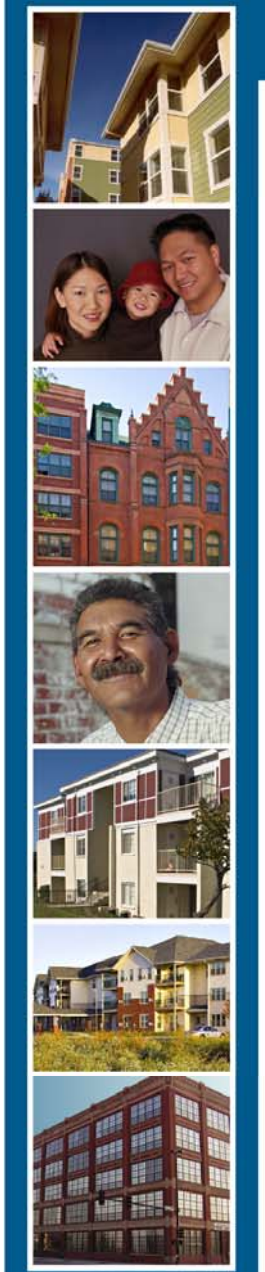

SOURCES AND USES

Sources	
New Mortgage	$800,000
City Loan (2nd Mortgage)	400,000
Reserves	300,000
Total	**$1,500,000**

Uses	
Payoff of Existing Mortgage	$700,000
City Loan (2nd Mortgage)	400,000
LP Interest	236,250
Capital Needs	80,000
Reserves	83,750
Total	**$1,500,000**

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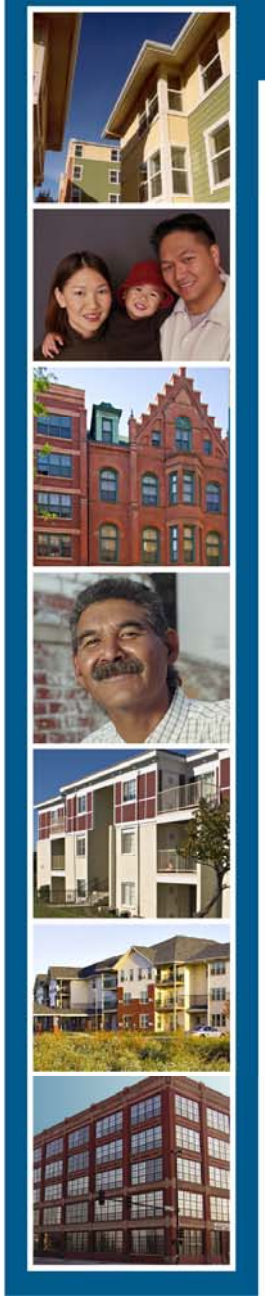

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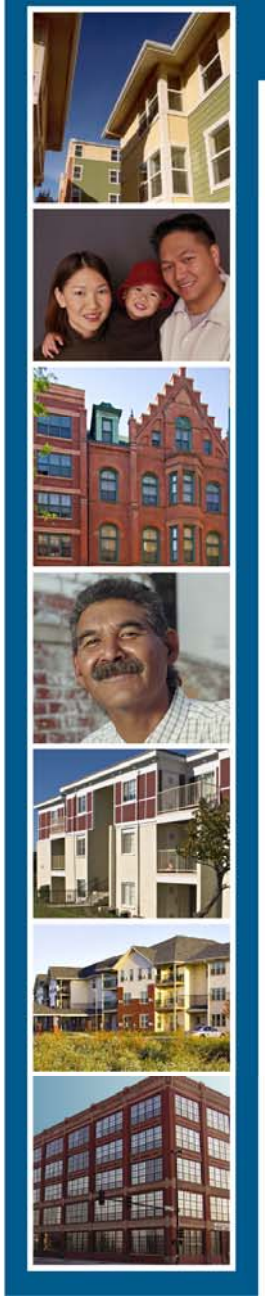

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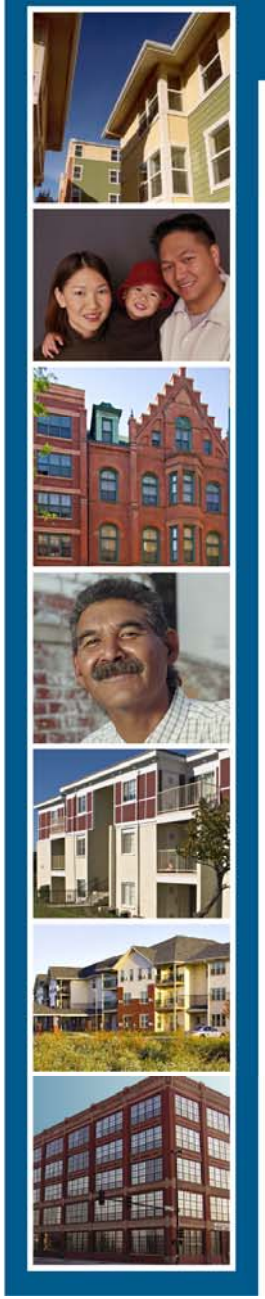

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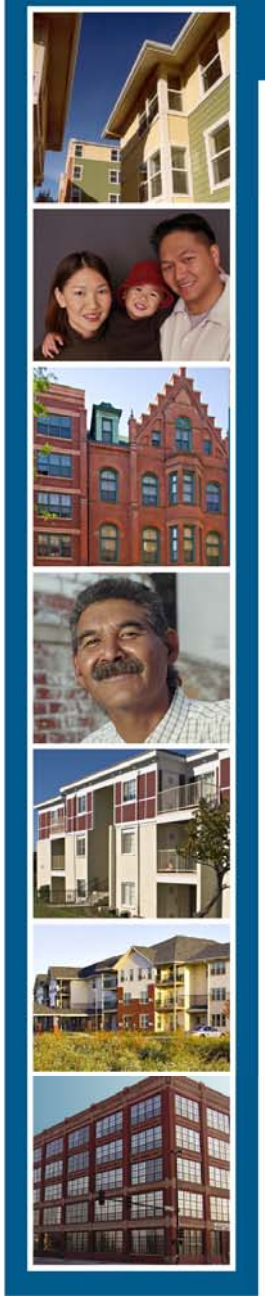
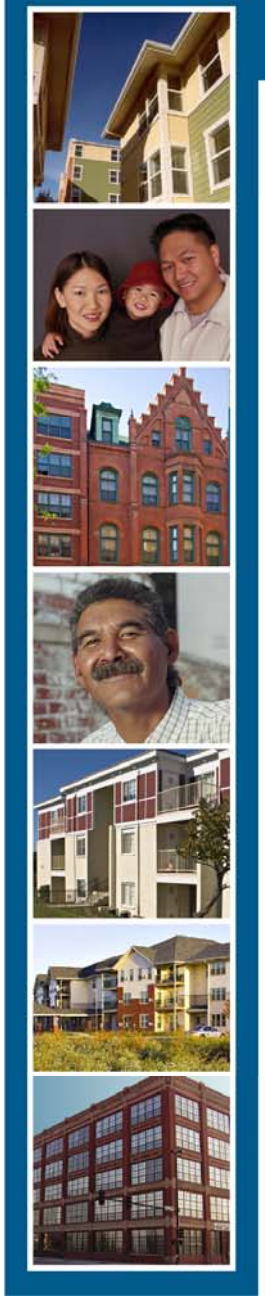


What Really Happened?



CASE STUDY

- GP and Enterprise agree to transfer LP's interest to a non-profit corporation for debt: $1,100,000
- Investor absorbed exit tax
- Why?
  - Nonprofit sponsor fostering affordable housing
  - Projected benefits delivered
  - Exit Tax exceeds FMV of Partnership Interest
  - Bargain Sale/Donation potential ($198,000)
  - Reserves stay with the property
  - No change of title to property
  - Fewer costs

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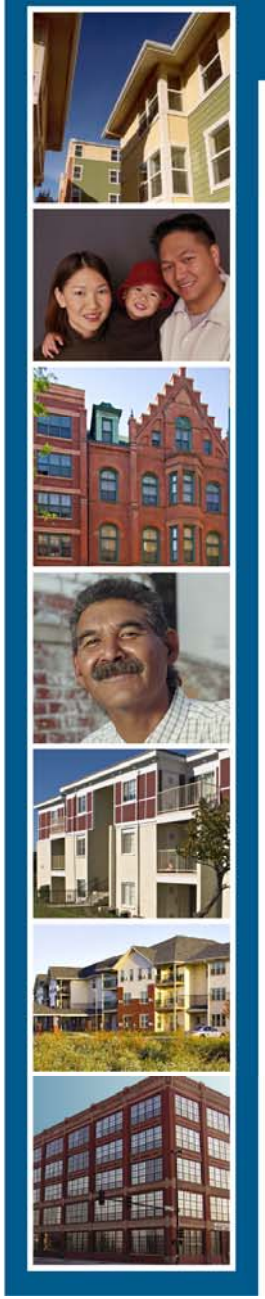

ENTERPRISE CONTACTS

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Director, Asset Management
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Assistant General Counsel and Chief Tax Counsel
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moconor@enterprisecommunity.com

For further information, go to the www.enterprisecommunity.com website, and look for Year 15 information under Asset Management.

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Year 15 Nonprofit Transition Strategies
For LIHTC Properties

SECTION C
Sample Partnership Agreement Provisions

[FIRST] AMENDED AND RESTATED AGREEMENT

OF

LIMITED PARTNERSHIP

OF

[NAME OF PARTNERSHIP]

Table of Sections

List of Exhibits

H	Projections
I	Investor Services Agreement
J	Right of First Refusal Agreement
K	Monthly Construction and Lease-up Status Report
L	Insurance Requirements Checklist
M	Tenant Services Agreement
N	[Outside Reserve Pledge Agreement]
O	[Equity Advance Note]

ARTICLE X

Assignability of Interests of Limited Partner

10.01 Substitution and Assignment of a Limited Partner's Interest

(a) A Limited Partner may not sell, transfer, assign, pledge, or otherwise dispose of all or any part of its Interest without the Consent of the Limited Partner and the Consent of the General Partner, the granting or denying of such Consent shall not be unreasonably withheld, and the payment by such Limited Partner or its assignee of all costs of such assignment including the costs of filing the amended certificate, if applicable; *provided, however*, the Limited Partner shall have a one-time absolute right to transfer up to fifty percent (50%) of its Interest or may transfer its entire Interest after the payment of its entire Capital Contribution obligation without obtaining the consent of the General Partner (a "***Permitted Transfer***"). The Partnership shall not be required to recognize any such assignment until the instrument conveying such Interest has been delivered to the General Partner for recordation on the books of the Partnership. If an assignee of the Limited Partner pursuant to this Section 10.01(a) does not become a Substitute Limited Partner pursuant to Section 10.01(b), the Partnership shall not recognize the assignment, and the assignee shall not have any rights hereunder or any rights exercisable against the Partnership to receive any portion of the share of profits, losses and distributions of the Partnership to which the Limited Partner would have been entitled if no such assignment had been made by the Limited Partner. Any such profits, losses and distributions shall continue to be allocated as if there were no assignment.

(b) An assignee of the Interest of a Limited Partner, or any portion thereof, shall become a Substitute Limited Partner entitled to all the rights of a Limited Partner if, and only if:

(i) The assignor grants to the assignee such right;

(ii) The General Partner, with the Consent of the Limited Partner, consents to such substitution, the granting or denying of which consent shall not be unreasonably withheld;

(iii) The assignor or assignee pays to the Partnership all costs and expenses incurred by the Partnership in connection with such substitution, including, without limitation, legal fees and costs incurred in the review and processing of the assignment, and in amending, if necessary, the Partnership's then current Agreement; and

(iv) The assignee executes and delivers such instruments, in form and substance satisfactory to the General Partner, as the General Partner may deem necessary or desirable to effect such substitution and to confirm the agreement of the assignee to be bound by all of the terms and provisions of this Agreement.

(c) Upon the admission of any Substitute Limited Partner, an amendment to this Agreement, reflecting such admission, shall be executed by the Partners. Such amendment shall reflect the name, address and Capital Contribution of such Substitute Limited Partner, and anything else required by the Act, and shall set forth the agreement of such Substitute Limited Partner to be bound by all the provisions of this Agreement. The General Partner shall file such amended Certificate as the Act requires.

(d) The Partnership and the General Partner shall be entitled to treat each Person set forth on Exhibit A as the absolute owner of its Interest in all respects, and shall incur no liability for distributions of cash or other property made in good faith to such owner until such time as a written assignment of such Interest has been received and accepted by the General Partner and recorded on the books of the Partnership. The General Partner may refuse to accept an assignment until the end of the next successive quarterly accounting period.

ARTICLE XIV

Buyout Option and Right of First Refusal

14.01 Buyout Option

At all times after the Compliance Audit Termination Date, and only if at such time or times the General Partner represents and warrants that (a) all of the buildings comprising the Project have been maintained in a decent, safe and sanitary condition and in a rentable state of repair, all in accordance with the Project rules and regulations and local codes, (b) the Units comprising the Project are operated as low-income housing in accordance with the provisions of Section 42 of the Code, and (c) the General Partner is not in default under any of the Project Documents, the Loan Documents or this Agreement, and no Event of Bankruptcy has occurred or is impending with respect to the General Partner or any of its Affiliates, the General Partner shall have the option (the "***Buyout Option***"), to purchase the Limited Partner's entire Interest in the Partnership for the "***Buyout Price***." The Buyout Option shall be exercisable upon at least thirty (30) days and not more than ninety (90) days prior written Notice to the Limited Partner. The Buyout Price shall equal the greater of (i) the Fair Market Value of the Limited Partner's Interest, subject to continued use of the Project for low-income housing for at least fifteen (15) years after the end of the Compliance Period, and at least through the end of the Extended Use Period, as of the date of the closing of the Buyout, or (ii) the sum of (A) all federal, state and local income taxes attributable to such sale, including those incurred or to be incurred by the partners of the Limited Partner; and (B) an amount required to provide the Limited Partner with the return described in Section 8.02(c) as of the date of said closing.

The General Partner's Notice to the Limited Partner (the "***Buyout Notice***") shall include (i) an appraisal of all of the assets of the Partnership (the "***Appraised Value***") by an appraiser selected by the General Partner, and (ii) a calculation by the Accountants of (A) the value of the Limited Partner's Interest based on such Appraised Value and (B) the Buyout Price, all calculated as of the closing date proposed by the General Partner in its Buyout Notice. The Limited Partner shall have thirty (30) days after receipt of the Buyout Notice in which either to accept the Buyout Price set forth in the Buyout Notice or to notify the General Partner of its desire to appoint a second appraiser to evaluate the Buyout Price. In the event that the Limited Partner fails to notify the General Partner within the aforesaid thirty (30) day period that it desires to appoint a second appraiser, it shall be deemed to have accepted the Buyout Price, in which event the Buyout Price shall be the price calculated by the Accountants and set forth in the Buyout Notice, and the General Partner shall purchase the Interest of the Limited Partner on the date specified in the Buyout Notice. In the event that the Limited Partner notifies the General Partner of its desire to appoint a second appraiser, the Limited Partner shall appoint such appraiser within thirty (30) days after it notifies the General Partner of its election, and the two appraisers shall together appoint a third appraiser within fifteen (15) days after the appointment of the second appraiser. The three appraisers so appointed shall each determine the Appraised Value of the assets of the Partnership within thirty (30) days

after the appointment of the third appraiser, and the Appraised Value of such assets for the purpose of determining the Buyout Price shall be the average of the three appraisers' determinations; provided that if one or more of the appraisers' determinations is more than ten percent (10%) higher or lower than the average of the three determinations, such appraiser's determination shall be disregarded in determining the Appraised Value of the assets, and provided, further, that if none of the appraisers' determinations is equal to or less than ten percent (10%) higher or lower than the average of the three determinations, the Appraised Value shall be the middle of the three determinations.

The Accountants shall determine the Buyout Price within fifteen (15) days after the three appraisers complete their determinations and prong (i) of the Buyout Price formula set forth in the first paragraph of this Section 14.01 shall be based on the amount of Sales Proceeds the Limited Partner would receive if the Property were sold for its Appraised Value, and the closing of the sale of the Limited Partner's Interest to the General Partner shall occur within sixty (60) days after the Accountants determine the Buyout Price. The entire Buyout Price shall be paid to the Limited Partner at the closing in cash or immediately available funds. The Limited Partner shall be responsible for the costs of the second appraiser and fifty percent (50%) of the costs of the third appraiser, if any, and for its own attorneys' fees incurred in connection with the closing. All other costs associated with the exercise of the Buyout Option, including the costs of the appraiser appointed by the General Partner, the Accountants' fees and any filing fees, shall be paid by the General Partner.

14.02 Right of First Refusal

In accordance with the Right of First Refusal attached as Exhibit K to this Agreement, the Partnership will not transfer, sell, alienate, assign, give, bequeath or otherwise dispose of the Partnership Property to any Person without first offering the Partnership Property for a period of forty-five (45) days to the Sponsor (if it then qualifies as an organization described in Section 42(h)(5)(C) of the Code) (the "***Purchaser***") at a price equal to the sum of (i) the principal amount of all outstanding indebtedness secured by the Partnership Property, all other loans from the General Partner or its Affiliates, and any accrued interest on any of such debt; (ii) all federal, state and local income taxes attributable to such sale, including those incurred or to be incurred by the partners of the Limited Partner; and (iii) an amount required to provide the Limited Partner with the Total Benefits described in Section 8.02(c) as of the date of closing; *provided, however,* that such right of first refusal shall be conditioned upon an agreement by the Purchaser to maintain the Project for low-income use for at least fifteen (15) years after the later of the end of the Compliance Period (but in no event can such low-income use terminate before the end of the Extended Use Period) under Section 42 of the Code or the date of the buyout and provided, further, that such restriction shall be recorded as a restriction against the Partnership Property.

ARTICLE VII

Allocations of Profits and Losses

7.01 Maintenance of Capital Accounts

The Partnership shall maintain a Capital Account for each Partner. Such Capital Account shall be maintained in accordance with Treasury Regulation Section 1.704-1(b)(2)(iv). To each Partner's Capital Account there shall be credited such Partner's Capital Contributions, and its distributive share of Net Profits and Gains and any item in the nature of income or gain allocated to such Partner under Section 7.02. To each Partner's Capital Account there shall be debited the amount of cash and the fair market value (as of the date of distribution) of any Partnership property (net of liabilities securing the distributed property that such Partner assumes or subject to which such Partner takes the distributed property) distributed to such Partner pursuant to any provision of this Agreement and such Partner's distributive share of Net Losses and Loss and any items in the nature of expenses or deductions that are allocated to such Partner pursuant to Section 7.02.

7.02 Profits and Losses

(a) After giving effect to the special allocations set forth in Section 7.03, the Net Profits, Net Losses, Loss and credits of the Partnership shall be allocated one-hundredth of one percent (0.01%) to the General Partner and ninety-nine and ninety-nine/one-hundredths percent (99.99%) to the Limited Partner; *provided, however,* that Gain shall be allocated among the Partners as follows:

(i) To the Limited Partner until the balance in the Limited Partner's Capital Account equals the sum of (x) the amount of the federal income tax liability imposed on the Limited Partner and its partners from a transaction giving rise to Sale or Refinancing Proceeds assuming all such Persons are subject to a federal income tax rate of thirty-five percent (35%), and (y) the Credit Deficiency;

(ii) To the General Partner until the balance in its Capital Account equals the unrepaid portion of any Operating Deficit Contribution or Additional Advance; and

(iii) The balance, among the Partners so that, to the extent possible, the ratio of (x) the balance of the Limited Partner's Capital Account in excess of the balance described in Section 7.02(a)(i) to (y) the balance in the General Partner's Capital Account in excess of the balance described in Section 7.02(a)(ii) is fifty to fifty.

Year 15 Nonprofit Transition Strategies
For LIHTC Properties

SECTION D
Action Steps

YEAR 15 TRANSITION STRATEGIES

ACTION STEPS

Step One: Review the Partnership Agreement for the Option and Right of First Refusal (ROFR) Agreement/Language

Locate and review the Option Agreement and ROFR Agreement (if applicable) for your project and answer the following questions:

1. Does the General Partner or the Sponsor have an **option** to buy:

   A) The Project? _____

   B) The Limited Partnership Interest? _____

2. Does the General Partner or the Sponsor have a **ROFR?** _____

3. When can the Option/ROFR be exercised?

   A.) Option: _____

   B.) ROFR: _____

4. Does your option and/or ROFR contain a fair market value (FMV) component?

   A) What is the buy-out formula for the Option?

   B) What is the buy-out formula for the ROFR?

   C) If there is a reference to FMV, how is it determined?

5. What use restrictions are in place? What is the term? What percentage (or number) of units are covered? What depth of affordability is required for which units (# or percent)?

Next Steps:

It is essential that your organization's leaders buy into the need to do Transition Strategies planning sooner rather than later, so we recommend attendees meet with the appropriate decision makers to go over the concepts and importance of devoting either internal staff or consultant's time to this process. This work will take time and you must be willing to devote the resources or it will be a reactive rather than a proactive exercise. Sometimes technical assistance grants may be available to carry out this process.

We recommend a property and portfolio approach and then a review with either your accountants/lawyers and or third party consultants familiar with the exit issues.

Quick Transition Strategies Check List:

- Obtain and review all necessary project information including but not limited to the Partnership Agreement, any amendments, most recent audits, tax returns, budgets, capital needs assessments, loan documents, extended use or land use restriction agreements.
- Determine current market position and value of property, estimate capital account balance, exit taxes and capital needs as of potential exit date,
- Review Income (including Section 8 contracts) and expenses with market comparables to evaluate current operations
- Determine rights of the Sponsor under the agreements and analyze cost/benefits of exit options; try and learn the position of the various players in the transaction.
- Develop a disposition strategy to propose to the Limited Partners including anticipated use of the property, use of operating and replacement reserves, debt repayment/restructuring, and handling of exit and transfer taxes.

Year 15 Nonprofit Transition Strategies
For LIHTC Properties

SECTION E
Bargain Sale

CHARITABLE DONATIONS OF PARTNERSHIP INTERESTS

Prepared by
Marian O'Conor, Esq.
Enterprise Community Investment, Inc.

As a general rule, when property is given to a qualifying charitable organization, the amount of the deduction is the fair market value of the property at the time of the gift. However, if property is transferred subject to a liability, the "bargain sale" provisions of the Code require that the transfer be broken down into two parts: the gift and a deemed sale. The tax law assumes that relief from a liability is equivalent to receipt of cash, and the transferor is therefore viewed as selling the property for the amount of the liability of which he has been relieved. The deduction for a charitable donation of property is equal to the fair market value of the property in excess of the debt secured by the property.

For purposes of the "bargain sale" provisions of the Code, "property" includes a partnership interest. Accordingly, the same rules apply to charitable donations of a partnership interest. The IRS has ruled that a charitable contribution of a partnership interest is subject to the bargain sale rules if the partnership has liabilities in which the donor has a share, i.e. partnership non-recourse debt.

Under the bargain sale rules, the donor has an amount realized equal to his share of partnership liabilities attributable to the donated interest. The partner's basis in the donated interest is allocated to the sale portion in the same ratio as the liabilities bear to the fair market value of the donated interest. The donor is entitled to a charitable deduction equal to the excess of the market value of his share of partnership assets over his share of partnership liabilities.

Example:

Partner A in equal partnership ABC has $800,000 basis in his partnership interest, which includes $900,000 in partnership non-recourse liabilities allocated to Partner A. The value of Partner A's interest is $1,000,000. He makes a charitable contribution of the entire interest to a qualifying charity. Although he receives no consideration for his contribution, the gift triggers the bargain sale rules. Partner A is therefore treated as having sold his partnership interest to the charity for his share of the partnership debt ($900,000).

Partner A would be entitled to a charitable contribution deduction of $100,000 (the difference between the fair market value of his partnership interest, $1,000,000 and Partner A's debt relief, $900,000). Partner A would also be required to recognize taxable gain, as follows:

Amount realized on the deemed sale	$900,000 (debt relief)
Partner A's basis allocated to deemed sale:	
$800,000 total basis x	
[$900,000 debt relief / $1,000,000 fair market value]	(720,000)
Taxable gain	$180,000

Year 15 Nonprofit Transition Strategies
For LIHTC Properties

SECTION F
Resyndication

YEAR 15 RESYNDICATION

Prepared by Craig Emden, Esq.

Bocarsly Emden Cowan Esmail Parker & Arndt, LLP

The purpose of this outline is to set forth general parameters for the transfer of low-income housing tax credit projects at the end of the 15-year compliance period in order to preserve the ability of a new tax-credit partnership (the "New Partnership") to enter into a tax credit transaction and to be able to use the acquisition credit.

I. Background

In order for a project to be entitled to claim acquisition credits on an existing property Section 42(d) of the Internal Revenue Code provides among other requirements that:

A. The building must be acquired by purchase from an unrelated party;
B. There must be at least 10 years between the acquisition of the project by the taxpayer and the date the project was last placed in service, <u>and</u>
C. The building must not have been placed in service by a related party.

For the purposes of A and C above, in general, a partnership is related to a person if that person has more than a 10% ownership in the partnership, or there is more than a 10% common ownership in the case of two partnerships.

II. Interim Transfers of Property or Partnership Interests

Transfers to Nonprofit Sponsors. A transfer of the project to a qualified nonprofit corporation is required in order for the nonprofit to exercise a right of first refusal under Section 42(i)(7) of the Code. This right of first refusal cannot be assigned to a partnership or other for-profit entity. The nonprofit would acquire the project for the right of refusal price of debt plus taxes and then sell the project to the New Partnership. The nonprofit would qualify for an exception to the 10-year placed in service rule as long as the 10-year rule had been met at the time of the acquisition by the nonprofit.

A transfer of the limited partnership interest would not constitute a transfer of the project and therefore would not trigger a new placed in service date. The existing partnership owner could then sell the project to a new partnership as discussed below.

III. Transfer to a New Partnership

A. The project could be sold to a new partnership (either by the old partnership or by the nonprofit after exercise of its right of refusal). The purchase price (and the

amount of the acquisition credit) would need to be determined based on the fair market value of the property supported by an appraisal.

B. Assuming the nonprofit or a related party had at least a 10% interest in the old partnership (either through residuals or cash flow fees which could be recharacterized), such parties must have under 10% of all partnership items in the New Partnership. Any partnership management or cash flow contingent fees need to be closely scrutinized to make sure those fees do not get recharacterized as a profits interest. To the extent the purchase price is represented by a note, it would have to provide for interest at least equal to the applicable federal rate (AFR) under Section 1274(d) of the Code.

C. The New Partnership must be unrelated to the old partnership at the time of its acquisition. Accordingly, the initial limited partner (before the ultimate investor is admitted) must be unrelated.

D. The limited partners of the old partnership must not be related to the investors of the New Partnership. For this purpose, the interests of two or more investors of the old partnership and the interests of two or more investors in the New Partnership will be aggregated. Thus, if two or more investors own, in the aggregate, more than a 10% interest in both partnerships, the New Partnership will not qualify for acquisition credits.

IV. Timing Issues

A. A carryover allocation needs to be issued in the year the acquisition expenditures are placed in service. Thus, the New Partnership will need to receive a carryover allocation in the year it acquires the project, even if it will be syndicated in a future year.

B. With respect to bond deals, if there is an acquisition and rehabilitation is separated in time, the IRS will scrutinize whether these are part of the same transaction in determining whether the acquisition credit is allowable.

If you have questions about this information, please contact Craig Emden at Venable, LLP (202-216-8521) or caemden@venable.com.

Year 15 Nonprofit Transition Strategies
For LIHTC Properties

SECTION G
Definitions

Accruing Interest
Interest calculated on the unpaid principal balance of a loan at rate stated in the loan documents.

Adjusted Basis
The cost basis of a building including any capital improvements minus depreciation.

Affordability Restrictions
Recorded tenant income and rent restrictions that are placed on a project by a city, state (including the state credit allocating agency), bank or other lender of funds to a project. These restrictions are monitored by designated credit agencies and are enforceable for a set period of time. The restrictions bind the property and are assumed by any purchaser of the property.

Allocation Date
Date the tax credits are allocated to the owner. Found on IRS form 8609.

AMI (Area Median Income)
Statistical expression used to calculate income guidelines for various projects funded under affordable housing programs. "Area" refers to the Census Bureau's definition of a metropolitan statistical area. For example, the median income for Ohio in 2002 was $51,900, meaning that half of the population of Ohio makes above this amount and half makes below it.

Amortization Period
The period of time over which debt is reduced by regular payments of interest and principal. If the amortization period equals the Term of the debt, then the loan is a fully amortizing loan and will be repaid in full as of the maturity date; if not, then a Balloon payment will be due.

Assignment/Assumption of Debt
One party assumes the liability of another party.

Balloon Payment
The amount of a loan that is unpaid at the end of its term (the unpaid balance). This occurs if the amortization period is greater than the term.

Basis Point
One – one-hundredth of a percentage point (.01%).

Buyout Option
The option giving the General Partner the right to purchase the Limited Partner's interest in the partnership at the Buyout Price.

Buyout Price
The greater of (i) Fair Market Value of the limited partner's interest or (ii) [unpaid benefits under some agreements plus] all federal, state and local taxes incurred as a result of the sale of the limited partner's interest.

Capital Account
The amount of capital contributed by a partner to a partnership increased by any income, gains and other increases and reduced by losses, distributions and other decreases allocated to that partner.

Capital Contribution
Equity (either cash or property) that is paid into (or transferred to) a partnership by a partner.

Capital Gain
The amount of gain recognized as the result of the sale of a capital asset.

Capital Improvements
Physical work that is completed on a project and is reflected as a capitalized expense.

Capital Loss

The amount of loss recognized as the result of the sale of a capital asset.

Capital Needs Assessment (a.k.a. CNA)

An inspection completed by an architect or engineer which identifies physical work that a project may need and/or a timeline of when repairs and capital improvements may be necessary. The report would typically include a schedule of roof replacements, water heaters, HVAC, etc.

Capitalization Rate (cap rate)

The rate used by an appraiser to determine a project's value under the income approach. The project's NOI is divided by the capitalization rate to derive the project's market value.

Charitable Contribution

A tax deduction that is taken when a taxpayer donates cash or property to a nonprofit entity. In a tax credit project, the limited partner may donate its interest, if there is value in the project.

Compliance Period

Begins the first year tax credits are taken for each building and ends December 31st of the fifteenth year thereafter. The owner can elect on the 8609 to begin taking credits the year the building is Placed In Service (PIS) or the following year. At the end of Year 15, the IRS will no longer require compliance monitoring because the tax credit compliance period will expire. For those projects that are bound by extended use restrictions, the IRS has authorized the State Housing Agency to create their own compliance monitoring rules for the duration of the extended use period. As of this date, State housing agencies are considering how to implement compliance monitoring rules, and these rules are expected to vary state by state.

Example: Building PIS 10/01/87 and owner elects to begin credit period in 1988. The Compliance Period ends 12/31/02

Credit Period

The ten-year period over which the low-income housing tax credit is usually taken. It generally begins on the date a property is placed in service, but a taxpayer may elect to start the credit period in the year following the year the low-income housing tax credit property is placed in service. Note that deferring the credit will extend the compliance period an additional year.

Deficit Restoration Obligation (DRO)

Provision in the partnership agreement requiring one or more partners to infuse capital into the partnership to restore negative capital account balances upon liquidation of the partnership or partner's interest.

Dissolution

The process of unwinding a partnership.

Disposition

The transfer or sale of an item, including a partnership interest or partnership property, reserves and other partnership assets.

Disposition Bond

A bond that may be posted to avoid credit Recapture upon Disposition of the property or partner's interest prior to the end of the compliance period.

Disposition Budget

The general partner should prepare a disposition budget to project expenses related to acquiring the partnership assets including staff time, deferred maintenance issues, legal and accounting, refinancing costs, and other transaction related costs required to transitioning the property for new ownership.

Equity

Cash or property contributed to a partnership by a partner. The partner receives a like amount of capital account credit for its contribution.

Exit Taxes

When the cumulative tax losses claimed by an investor exceed the amount of capital invested, then the investor will recognize a gain at the time of disposition of the property or investor's interest in the partnership. This gain is taxable, and will result in a tax liability, which is referred to as an "exit tax," meaning the taxes due when the investor exits the partnership.

Extended Use Agreement

An agreement between the owner and housing credit agency extending the low-income housing restrictions an additional 15 (or more) years beyond the initial Compliance Period. Federal extended use agreements are required for LIHTC projects with credit allocations after 1989, and many states impose additional extended use restrictions.

Fair Market Value (FMV)

The value of the partnership assets determined by a third party appraisal.

Fiduciary Responsibility

The responsibility of a person or company (syndicator) to act for the benefit of a beneficiary (investor), within the scope of the relationship.

Foreclosure

An action by a Lender to judicially sell property in order to satisfy its debt caused by the failure of a party to make required payments on a mortgage loan. Upon foreclosure, title to the property transfers to the purchaser at the foreclosure sale.

Forgiveness of Debt

The entity holding claim to a debt/loan acknowledges and waives its right to repayment of that debt. Forgiveness of debt is income to the party whose obligations have been released.

8609 Form

IRS document that is filed with a partnership tax return, for each year during the Compliance Period, declaring the amount of tax credits for each building and the placed in service date. This is issued after construction is completed and all costs are accounted for.

Gross-up Factor

A method of calculating the income tax cost to an exiting partner whereby the limited partner's income tax incurred upon exiting or dissolving a partnership is multiplied by a factor to account for the tax on the income that the limited partner will receive when the general partner pays the limited partners exit tax (i.e., 135% where the tax rate is 35%).

Hard Debt, 1st Mortgage, Must Pay Debt

Any debt or liability incurred by the partnership with required payments regardless of cash flow.

HOME Funds

Federal Funds that may be granted or loaned to a project from a City or State government. If a loan, the interest rate, term and amortization period may vary per project.

HOME Compliance Period

For rehabbed units, the compliance period is 15 years and for new construction, 20 years. Tenant files are required to be maintained for an additional 3-year period after move-out. The Partnership should confirm with their local HOME administrator on the monitoring requirements in years 16-20. It is assumed that HOME agencies will monitor HOME units after year 15.

Internal Rate of Return (IRR)

The IRR for an investment is the discount rate at which the total present value of future cash flows equals the cost of the investment.

Lease-Purchase Option Agreement

The Option Agreement is the document that gives a resident the contingent right to purchase his/her home from the Partnership after the 15 year Compliance Period. It is contingent on: 1) the Partnership taking title to the property; and 2) the resident remaining a tenant in good standing. The Option Agreement provides a framework for the purchase price formula, notification to the resident prior to year 16 and the amount of time a resident will have to exercise his/her option.

Lease-Purchase

Single Family homes that may be rented for 15 years and then sold to an income eligible tenant at the end of the 15th year. The unit will then be released by the state allocating agency from the additional 15 year extended use compliance period.

Land Use Restriction Agreement (LURA)

The document containing Affordability Restrictions and other restrictions placed on the project.

Limited Liability Company

A state law ownership entity comprised of one (in certain states) or more Members, which in a tax credit deal is formed for the sole purpose of owning real estate. Limited Liability Companies are disregarded entities for state and federal tax purposes so the losses, credits and profits are passed through to the partners based upon their respective interests.

Limited Partner

The limited partner is typically an investor or investors, or a fund made up of investors, who own up to 99.99% of the interests in the limited partnership. The limited partner(s) look to the general partner of the partnership to oversee the day to day operations of the partnership. The limited partnership is a vehicle for investors to receive a return on their investment in the form of tax credits, loss benefits and residual value upon disposition.

Limited Partnership

A state law ownership entity comprised of a general partner and one or more limited partners, which in a tax credit deal is formed for the sole purpose of owning real estate. Limited partnerships are disregarded entities for state and federal tax purposes so the losses, credits and profits are passed through to the partners based upon their respective interests.

Limited Partnership Agreement

A comprehensive agreement between the limited partner and general partner that reflects the duties, rights, fiduciary obligations and responsibilities of the partners. The Partnership Agreement is the definitive guide to financial requirements and oversight of the operation and disposition of the partnership assets. Partnership Agreement requirements vary by syndicator and by investment funds.

Low-Income Housing Tax Credit (LIHTC)

The federal tax credit allowed by Section 42 of the Internal Revenue Code.

Lower Tier

Refers to the property-level operating partnership or limited liability company whose partners or members are partnerships, generally referred to as Upper Tier Partnerships.

Member

A non-managing member is typically an investor or investors, or a fund made up of investors, who own up to 99.99% of the interests in the Limited Liability Company. The non-managing member(s) look to the managing member of the company to oversee the day to day operations of the company. The limited liability company is a vehicle for investors to receive a return on their investment in the form of tax credits, loss benefits and residual value upon disposition.

Minimum Sales Price

Applies to Qualified Contract terms for projects with Extended Use Agreements. Per Section 42(h)(6) of the Code, the Minimum Purchase Price for a 100% low-income building equals the outstanding indebtedness secured by the building, plus adjusted investor equity in the building, plus other capital contributions less cash distributions. (Adjusted investor equity means the amount of cash invested with respect to the project increased by the cost of living adjustment for the calendar year.) Until further regulation by the IRS, subject to clarification and interpretation on a state by state basis.

Minimum Gain (704b)

The amount by which nonrecourse debt secured by the Property (land and buildings) exceeds adjusted basis in the security property.

Non-Recourse Debt

Debt for which no one can be held personably liable (i.e., no partner bears economic risk of loss). So, the creditor's only remedy upon default is usually to foreclose upon the property that secures the debt.

Operating Reserves

Funds set aside for a project to utilize if the project is unable to meet its cash flow needs or does not have the funds available to pay for a Capital Improvement. Note: Reserves are assets of the partnership and may be available for distribution to the partners upon sale of the property, unless they are collateral for existing loans. Through negotiation, reserves may be donated to the nonprofit sponsor, expensed as a fee, capitalized into the property or used to pay exit taxes. Some partnership agreements provide for an Exit Tax Reserve to pay exit taxes.

Outstanding Debt

The sum of all debt secured by the Project including accrued interest, that is due and payable at the end of the Compliance Period. Note: Although a loan may have a 30 year term, upon a transfer, including at year 15, all debt must be repaid, assumed or forgiven, unless the lender approves assumption of the debt by the new owner.

Placed In Service Date (PIS)

The date the building is ready for occupancy, usually evidenced by a Certificate of Occupancy.

Reallocation

Changing the allocation of taxable deductions or benefits during the Compliance Period. One method to reduce exit taxes to a limited partner is by reallocating losses from the limited partner to the general partner.

Recapture of Tax Credits

The owner is obligated to maintain the required percentage of low-income units in the project, and by building, through annual tenant income certifications and rent restrictions. Failure to meet this obligation can result in the filing of form 8823 (LIHC Agencies Report of Noncompliance or Building Disposition) with the IRS and the recapture of credits for the unqualified units. General partners are generally obligated to provide tax credit guaranties if any units fall out of compliance. Foreclosure on the Project or sale of the Project (or a partnership interest) before the end of the Compliance Period can also cause recapture unless a bond is posted and the Project remains low-income.

Residency Credit

A residency credit is incorporated into the Lease Purchase purchase price formula to address the issue of fairness (e.g. a one year resident might otherwise realize as much equity as a fifteen year resident). To address this concern, the Option Agreement adds some amount, i.e. $15,000 to the sale price of each house, and then subtracts $1,000 for each year of residency up to fifteen years. Any surplus revenues earned by the general partner can be used to offset costs associated with implementing the Option Agreement or to fund other program goals or expenses.

Replacement Reserves

Reserves, usually funded from current cash flows, established to replace long-lived items on the property. See discussion of Operating Reserves.

Resident Tenant Option Agreement

See Lease Purchase Option Agreement.

Residual Value

The value of an interest or real estate after all costs of sale (including repayment of all mortgages) have been deducted.

Resyndication

The process of applying for new tax credits once a project's Compliance Period is over. Note: The IRS allows projects to receive new tax credits following the end of the Compliance Period if they are eligible under the State's Qualified Allocation Plan (QAP). Some State QAP's provide special set asides to preserve affordability. The IRS has special regulations regarding the ownership structure with resyndicated projects and the Sponsor should consult with their attorney and/or CPA to review the requirements.

Right of First Refusal

A right offered to tenants (in co-operative form or otherwise), a resident management corporation, a qualified non-profit organization or a government agency, which allows the holder the right to purchase the real property (real estate) at a Minimum Purchase Price. The Minimum Purchase Price is equal to the principal amount of indebtedness secured by the property (other than indebtedness incurred within the 5-year period ending on the date of the sale to the purchaser), and all Federal, State, and local taxes attributable to such sale. This right may or may not require an offer from a third party to purchase the real property. Statutory authority for the right of first refusal is contained in Sec. 42(i)(7) of the Code, which applies to projects with LIHTC tax credits allocated after 1989.

704b Analysis

An analysis of the capital accounts of the partners, minimum gain generated by the project and the potential impact on the allocations to the partners as a result of such analysis.

Sale of Limited Partner Interest

The limited partner's interest is sold or transferred to another party. The sale of the interest may be as little as $1.

Sale of Real Estate

The sale of the real estate owned by the partnership. After the real estate is sold, the partnership may be dissolved. This may cause an assessment of transfer taxes. Any reserves associated with the project are assets of the partnership, not part of the real estate, and may be available for distribution at dissolution.

Sponsor Debt

A loan made to a project from a sponsor. Typically these are 2nd, 3rd, or 4th mortgages that are cash flow contingent and have accruing interest.

Syndicator

This corporate entity, e.g., Enterprise, raises capital from corporations for investment in housing qualifying for Low-Income Housing Tax Credits. The syndicator is usually the general partner of a Fund that is the limited partner in a LIHTC limited partnership.

Tax Credit Recapture

See Recapture.

Taxable Gain

See Capital Gain.

Taxable Loss

See Capital Loss.

Tax Rate

The rate at which exit taxes are calculated. For corporate taxpayers the Federal tax rate is usually assumed to be 35%; an additional state tax rate may also be applied.

Tax vs. GAAP

Different methods of financial presentation.

Term

The length of time before a loan is due to be repaid.

Total Benefits

Amount of benefits, generally Low Income Housing and/or Historic Tax Credits plus losses that the Limited Partner is expected to receive. Often discounted back to reflect a targeted return on investment.

Transaction Costs

Expenses related to sale or transfer of a property or a partnership interest. Costs may include items such as title work, appraisal, accounting fees, legal fees, transfer taxes and transfer fees.

Transfer Tax/Fee

A fee that is charged by a governmental entity upon sale (transfer). This fee may be incurred if the project is sold, but may be avoided in some states if the partnership interests are sold instead.

Upper Tier

The investment partnership where the syndicator is the general partner and investors are the limited partners. Some syndicator reserves may be held at this level.

Yield Maintenance

A method that allows an investor to receive additional benefits in order for it to obtain its projected tax benefits. In a year 16 transaction, this could be payment of cash to the limited partner to increase its total benefits to the amount originally projected. In earlier years, it could be an adjustment to a capital contribution.

Contributors to these definitions included:

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Enterprise Community Investment, Inc. is a leading provider of the development capital and expertise it takes to create decent, affordable homes and rebuild communities. Enterprise leverages low-income housing, new markets and historic rehabilitation tax credits; short- and long-term debt, and development services to capitalize projects that make a catalytic difference in communities. For over two decades, Enterprise has privately raised $7 billion in capital to finance affordable housing, create vital communities and help transform the lives of low-income Americans, particularly those at the lowest end of the economic scale. Currently, Enterprise is investing in communities at a rate of $1 billion a year. Visit www.enterprisecommunity.com to learn more about Enterprise's efforts to build communities and opportunity.

 07.18.06

Year 15 Nonprofit Transition Strategies
For LIHTC Properties

SECTION H
Articles

Forward planning, low rehab needs minimize California's Year 15 problems

By Maria Del Rio

Confronting the Year 15 challenge

For much of the past two years, state housing finance agencies have been studying the problem of what happens at the end of the initial 15-year occupancy restrictions for low-income housing tax credit (LIHTC) properties. Trying to manage an exit strategy for some investors and maintain the affordability of precious low-income housing, they have been assessing the extent of their Year 15 challenge and working up plans for responding.

LIHTC properties that came online between 1986 and 1989 could be sold without federal restrictions. Effective in 1990, Congress doubled the affordability period for LIHTC developments from 15 years to 30 years. It also provided an exit route for owners at the end of the Year 15, in which they could request the state allocating agency to either purchase the project or to find another purchaser. If the agency didn't buy or find a buyer within one year after the request, the property would be freed from the affordability requirements – albeit with a three-year transition period restraining rent increases and evictions of low-income tenants.

In this Year 15 special focus, you will find information on what several states are doing to handle the problem, as well as ideas for using tenant ownership in your exit strategy.

For more on Year 15, see *Affordable Housing Finance*, July 2004, page 34, and September 2004, page 56. The North Carolina Housing Finance Agency has a PDF file with Year 15 resources that are helpful for owners in any state. Go to www.nchfa.com/Rental/My15.aspx and click on the "Y15 bibliography" link.

Though tax credit projects across the country are completing their 15-year compliance periods and the limited partners are exiting, the issues are not the same everywhere.

In many states, regulations permit a tax credit project that completes Year 15 to rid itself of rent and income restrictions, although the rents might not actually increase because of market conditions. In the Golden State, chances are that other funding sources will continue to impose rent and income restrictions, without which rents would leap skyward. (California's tax credit program initially required only 15 years of restrictions but now it requires 55 years.)

So the issues in a California Year 15 transfer are not so much about legal and regulatory preservation as they are about assuring that the project is preserved through sufficient capitalization and providing needed rehabilitation. The "at-risk" factor in California projects is economic and physical need, and the "headache" factor is the need to work around short-sighted early partnership agreements.

Virtually all limited partners (LPs) want to get out of tax credit projects after their 15-year commitment is up, prompting disposition of the projects. Provisions concerning disposition in the early tax credit partnership agreements were overly optimistic, as it has turned out. Investors were promised more cash at the back-end, and the general partner (GP) was given only an "option to buy," with no parameters on what would constitute an acceptable purchase price.

This makes dispositions tricky and time-consuming, but luckily the industry quickly grew more savvy in drafting optimal agreements. The next generation of transfers will more commonly be projects in which the GP was provided a right of first refusal and a purchase price of debt plus taxes.

Developers with deals that require some rehab and recapitalization are looking to tax-exempt bonds and the 4% tax credit because the 4% credits aren't competitive and result in quicker funding, compared to 9% credits, said Joel Rubenzahl, director of Community Economics, Inc., in Oakland. Also, "acquisition cost is included in basis for bonds with 4% credits." Data from the California Tax Credit Allocation Committee supported this assessment: Lynn Wehrli, executive director, noted that disposition deals have accounted for 10 applications for 4% credits and only one application for 9% credits.


Joel Rubenzahl

Bonds and other challenges

The 50% test, which requires the bonds to cover at least 50% of the total project cost, "is very tricky," said Rubenzahl. Tax credit disposition deals have difficulty meeting the 50% test because of the continued below-market public loans on the projects, which almost always account for more than 50% of the total acquisition and rehab

project cost.

"The subordinate public lenders in projects that seek rehab and recapitalization through bonds have to accept a partial payoff to reduce the non-bond project indebtedness below 50% of the total project cost," Rubenzahl explained. This also means the note and loan agreement have to be restructured and rewritten to extend the term for another 55 years, to meet California's 55-year compliance period for tax credit projects and because the new investors won't accept other funding sources in the project with a shorter term than the tax credit compliance period.

However, that's not so easy to pull off. "Some local government lenders are reluctant to restructure and rewrite their notes and loan agreements," he noted. "This makes deals very hard to negotiate. At the state level, on the other hand, the California Department of Housing & Community Development, a major source of below-market funds, has been responsive to renegotiating its debt agreements."

Rubenzahl is working on more than 20 dispositions right now. The most difficult projects are those with Department of Housing and Urban Development (HUD) funding: "We can forget about changing [HUD], so we just find ways to work with them in their environment."

Appraisals are very important and complicated in the transfer of tax credit projects, Rubenzahl added. "There's a lot of controversy about appraisals and they require a lot of negotiation. These deals are very difficult – in California, only a small number have closed, and these are generally the less complicated ones, where debt is higher than market value and rehab isn't required. Deals that aren't worth the debt [because the appraised value is less than the debt] are the easiest to deal with, because the general partner [GP] just takes over the debt."

Burbank Housing spent three years planning the Year 15 resolution for its Fitch Mountain Terrace property in Healdsburg, Calif.

Jerry Breed, a partner with Powell, Goldstein, Frazer & Murphy, in Washington, D.C., agreed that disposition of tax credit projects is highly challenging. Focused on just getting through the transfer, "GPs have been avoiding the really tough issues during the exit transaction – they're doing 'rinse and spin' rehabs, minimizing the amount of rehab needed. These projects have physical problems and no financial resources to fix the problems," he said.

Jerry Breed

Lay the groundwork

Luckily, BRIDGE Housing of San Francisco had sufficient reserves to cover the $700,000 cost of the rehabilitation for Coleridge Park Apartments, the first tax credit project disposition in which it became involved, which closed recently in San Francisco. BRIDGE and its co-sponsor, Bernal Heights Neighborhood Association, developed the 49-unit seniors project and were co-GPs. Rehab needs include a new roof, siding, painting, parking area improvements and possibly new appliances. With funds provided by a special grant, Coleridge Park will also undergo a "greenhab" to improve the building's environmental performance, focusing on air quality, energy and resource efficiency, and material sustainability.

BRIDGE and its co-sponsor were able to buy only the interest of the limited partnership, instead of buying the project, which eliminated some of the complexities and reduced the transaction costs. This also avoided the need to rewrite subordinate debt, said Lydia Tan, BRIDGE's executive vice president. Other funding sources included a loan from the redevelopment agency and one from MetLife, which was paid off in the 10th year. A Rural Development Administration loan is still in place.

The biggest difficulty has been pricing the limited partner's interest, according to Tan. "We recently completed the transfer of three projects in the San Francisco Bay Area, without any appraisals – it's all been through negotiation," she said. BRIDGE's out-of-pocket cost to take over Coleridge Park was agreed to be solely the taxes owed by the limited partners, but the organization actually paid less than that because of the largesse of the National Equity Fund (NEF), which was the limited partner

"Who keeps the reserves is part of the negotiation," Tan noted. "So far, the

reserves have stayed with their projects."

Tan recommended that other general partners "start early and have a really good handle on the rehab needs and costs and a strategy to renegotiate with the LP," she said.

Plan ahead

This strategy also worked well for Burbank Housing in Santa Rosa, which just closed its first two transfer deals in Healdsburg and Petaluma. "We started planning three years prior to the transfer, something everyone should do," said John Lowry, executive director. With that forward planning, Burbank realized that the "second transfer deal was going to have tax problems at exit due to the LP writing off too many losses, so Burbank and the LP, which is NEF, agreed to amend and restructure the partnership agreement in Year 13 so that Burbank would receive a share in the tax liability. Through this maneuver, they avoided enough of the tax problems so that the project could be transferred relatively easily.

Burbank's two transfers are small properties, with fewer than 25 units, and have not required rehab or recapitalization. In both transfers, NEF was the LP and was simply replaced in the partnership agreement by the property manager, an affiliate of Burbank that became the co-general partner. This dispensed with the need to dissolve the partnership, and all of the project debt was assumed without need for restructuring. Both projects had Community Development Block Grant and HOME funds.

"NEF was very easy to work with, and that was key to the deal," said Lowry. The reserves have stayed in Burbank's projects, also.

Burbank will have another Year 15 acquisition in 2006, and then approximately one per year thereafter. BRIDGE has three or four more projects completing their 15-year compliance periods in the next couple of years. The first of these will have a number of physical issues, said Tan. Also, the LP in one is exercising its "put," the right it was given in the partnership agreement to require a sale, so it will be a difficult negotiation, she predicted. "Our attitude is however difficult, just get it done."

Tan was joined by both Breed and Rubenzahl in lamenting the old partnership agreements, which were unclear and lead to issues such as defining and establishing fair market value, and which promised cash out to the investor at the back-end based on value and sometimes minimum investor payments.

Breed said that "some investors want residual value/priority return. Early deals anticipated investors getting substantial payments at the end of the 15 years – more market value and more gains – and that's not realistic. What investors thought they were buying 15 years ago was not what they actually bought. Tax credits were only part of the deal for investors at the start of the tax credit program." ■

Dealing with corporate LPs

A number of deals with corporate LPs are soon approaching Year 15. Given the spirited discussion and popularity of a workshop at the Housing California Conference in April, negotiations between these investors and project sponsors on exit strategies could be very interesting.

During a discussion of how losses that exceed the original investment turn into gains during the LP's exit, a workshop attendee from a large equity investor noted that losses would have to be measured against what was projected originally, and that this would influence what the disposition deal would be.

This prompted another participant to recommend that the front-end people at the investment companies, who are trying to get deals, should talk to the back-end attorneys and asset managers. "If an investor gets a reputation as a hard-ass, they won't be getting many new deals," he said.

States get creative to preserve affordability

By Eric Wong

State housing finance agencies (HFAs) are moving forward to meet their obligations under Sec. 42 to find buyers for post-1989 projects that have reached the end of their initial 15-year low-income housing tax credit (LIHTC) compliance period. The first step in that process is for the HFA to set what the law calls a "qualified contract price" to purchase a property.

Three states have published policies that require extensive documentation so that the price can be calculated by third-party accountants hired by the HFA. They include North Carolina, Virginia and Colorado.

At least five states are supplying worksheets to owners to let them calculate the price for approval by their HFAs: Florida, North Dakota, South Dakota, Texas and Washington.

If a state cannot find a qualified buyer at the qualified contract price, then the owner is released from occupancy restrictions subject to a mandatory three-year transition period that protects residents from rent increases and unjustified evictions.

A number of HFAs are providing incentives for owners to preserve affordability rather than opting out of the program. In addition to setting aside large portions of their federal LIHTC allocations, they are also using their own resources, building up cash reserves by refinancing old housing bonds, said Vincent O'Donnell, vice president for preservation for the Local Initiatives Support Corp. (LISC).

California, Illinois, Massachusetts, Minnesota, New York, Pennsylvania, Virginia, Washington and Wisconsin are states that O'Donnell cited as providing creative financing for preservation.

Here's a look at what some of these states are doing to handle Year 15, deal with compliance in the extended-use period, and provide preservation incentives:

IF A STATE CANNOT FIND A QUALIFIED BUYER AT THE QUALIFIED CONTRACT PRICE, THEN THE OWNER IS RELEASED FROM OCCUPANCY RESTRICTIONS SUBJECT TO A MANDATORY THREE-YEAR TRANSITION PERIOD THAT PROTECTS RESIDENTS FROM RENT INCREASES AND UNJUSTIFIED EVICTIONS.

Texas

The Texas Department of Housing and Community Affairs (TDHCA) has drafted a proposed qualified contract policy to assist owners of post-1989 LIHTC properties that want to exit the program after the initial 15-year compliance period.

The proposal would allow property owners, at the end of the 14th year of the compliance period, to ask TDHCA to help them find a buyer for the property at the qualified contract price. If TDHCA cannot locate a buyer within one year, the extended-use commitment would expire (although the three-year federally mandated transition period would remain).

The policy is in draft form and was to be published in the *Texas Register* for public comment. While the proposal allows owners to submit their own calculations of value, TDHCA would have the right to ask for more information to document price and to engage its own certified public accountant (CPA).

Edwina Carrington, executive director of the agency, said she does not expect to see many sales at the qualified contract price because it's going to be pretty high in many cases.

The backbone of TDHCA's preservation efforts is its qualified allocation plan (QAP) set-aside, which reserves 15% of its $40 million in tax credits for rural housing at risk of converting to market-rate. This year, the set-aside could help allocate $5.8 million in tax credits to these projects.

The QAP also allows at-risk rural housing tax credit applicants to come again to TDHCA for a first-come, first-served forward commitment of tax credits for affordable housing preservation. The "rural rescue" program, which was introduced in the 2004 tax credit round, can allocate a total of $2 million in tax credits for this purpose.

In addition, TDHCA, like some other state housing finance agencies, is considering relaxing its compliance rules for the extended-use period. For example, instead of monitoring an affordable housing project every three years, the agency might do so only every five years, said

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The agency may also modify its tax-exempt bond program to offer 30 points, instead of 10 points, for affordable housing preservation if a project has or had affordable housing units within the past 10 years.

The proposal will be finalized in August.

TDHCA has also offered other types of financial assistance to preserve affordable housing. It recently capped its two-year Preservations Incentives Program by awarding more than $4 million to preserve 10 projects with a total of more than 500 affordable units.

At press time, the balance of funding available to the program had reached a level that made it unfeasible for TDHCA to consider new applicants. It hopes to identify new funding sources for this program and release a new open cycle in the future, said David Danenfelze, multifamily program administrator.

Washington

The Washington State Housing Finance Commission (WSHFC) was one of the first state housing finance agencies to develop a strategy to help market and sell a LIHTC property to a qualified buyer at the end of the 15-year compliance period in order to preserve the property's affordability.

WSHFC also established a new set of monitoring procedures for tax credit properties after Year 15 by allowing waivers for certain requirements. "We believe these changes will prove to be beneficial to owners and managers of tax credit properties by streamlining reporting requirements during this period," said the agency.

Another important preservation tool is the Washington Area Community Investment Fund (WACIF). It offers preservation projects financing such as predevelopment loans, acquisition bridge loans, subordinate loans for Mark-to-Market transactions, and Sec. 8 reserve guarantees.

To date, WACIF has funded 133 loans totaling $9.6 million for nonprofits, leveraging $80 million in public and private capital, resulting in the preservation of 1,437 units of affordable housing and 20 community-based facilities.

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The Minnesota Housing Finance Agency (MHFA) has an annual $9.3 million affordable rental housing preservation investment fund that provides low-interest deferred loans. The fund can finance the costs of acquisition, rehabilitation and debt restructuring of federally assisted developments, as well as equity take-out deferred loans. The funds could also be used to finance existing supportive-housing properties.

The owner of an eligible property must enter into an agreement to keep the housing affordable for the maximum term permitted by the federal programs involved. The owner must also give local government; housing and redevelopment authorities; and nonprofit housing organizations the right of first refusal if the rental property is subsequently offered for sale and an outside offer is received.

However, MHFA dropped its 20% set-aside for preservation in this year's QAP. There were not enough credits to include preferences for both homelessness and preservation, said the agency.

Minnesota charges a $5,000 application fee for owners seeking to use its qualified contract exit route at Year 15. The owner also has to pay for submission materials, an appraisal, a market study, and a rent comparability study, according to Molly O'Dell, a CPA with Novogradac & Co., LLP.

Illinois

The state updated its preservation laws to help save more than 33,000 federally assisted housing units over the next five years (see *Affordable Housing Finance*, October 2004, page 2).

The state's 2004 Federally Assisted Housing Preservation Act stretched the previously restrictive definition of "subsidized housing" to include all project-based Sec. 8 properties, LIHTC proper-

Continued on page 35

States get creative

Continued from page 33

ties, and developments with mortgages insured by various Department of Housing and Urban Development (HUD) programs. Owners must now give 12 months instead of six months notice of intent to sell one of these properties.

The law also expands the number of events that would give tenants the right to buy their buildings, and it allows tenant associations to transfer their purchase rights to a third-party developer.

In addition, the state's housing task force this year made preservation a top priority for the next three years.

The Illinois Housing Development Authority continues to have a $3 million set-aside for preservation projects in its QAP.

Massachusetts

MassHousing's QAP sets aside 40% of its tax credits for the preservation of affordable housing. This category includes both federally and state-assisted housing, as well as HOPE VI projects.

MassHousing also refinances existing properties that use HUD-subsidized mortgages where 20% of the units must remain affordable to households earning no more than 80% of the area median income (AMI), or no more than 50% of AMI if HUD risk-sharing is used for credit enhancement.

The Massachusetts Housing Partnership Fund, a quasi-public lender, is another good source for preservation financing, said LISC's O'Donnell. It has closed a number of preservation transactions with primary mortgage loans and no additional credit enhancement.

Unfortunately, the state has terminated its Capital Improvement and Preservation Fund, which helped preserve 2,600 units of affordable housing. Since 2002, the program had committed more than $31 million to affordable housing. The state Department of Housing and Community Development said that it intends to focus exclusively on expanding the housing supply. ■

Tenant ownership provides viable options

By John Brandenburg

The low-income housing tax credit (LIHTC) has helped make affordable housing a reality for millions of Americans. However, the major tax benefits that make LIHTC projects attractive to investors are fully realized in 15 years. Then what?

For projects with credits allocated after 1989, federal law mandates that affordability must be extended for at least another 15 years. A provision in the Internal Revenue Code allows a developer to opt out of the extended-use requirement for a particular project, with state approval, if the state is unable to find a buyer at a formula price (see *Affordable Housing Finance*, July 2004, page 34, and September 2004, page 56).


John Brandenburg

And by Year 15, most investors are looking for exit strategies. Nonprofit developers, however, seek solutions to sustain affordability.

A number of disposition options are available to LIHTC partners, including selling a property to the developer, which may continue to operate it as affordable housing; transferring the property to a charitable organization or government entity; or finding investors to reinvest in the property by using new tax credits to upgrade it for the next 30 years. Federal law allows nonprofit organizations, tenants, tenant co-ops, or government agencies the right of first refusal to purchase properties at a bargain price. If adequate financing is feasible, this can be a winning strategy for everyone.

Selling properties to residents represents another viable option. There are several strategies that allow for resident ownership, including lease-purchase agreements, cooperative (co-op) conversions, and condominium conversions.

Lease-purchase agreements

In some cases, projects are designed from the beginning for eventual sale to residents. These projects are set up under a lease-purchase concept, with the understanding that residents will buy their units when the project reaches Year 15.

> LEASE-PURCHASE PROGRAMS OFFER A TANGIBLE BENEFIT TO LOW-INCOME RESIDENTS: THE OPPORTUNITY FOR HOMEOWNERSHIP.

The Cleveland Housing Network (CHN) pioneered this strategy when the LIHTC program was in its infancy. In January 2005, CHN and The Enterprise Social Investment Corp. (ESIC) began transitioning the latest group of 50 homes, which were developed in 1990, and expect to sell 90% of these units to residents.

Lease-purchase programs offer a tangible benefit to low-income residents: the opportunity for homeownership. These residents are more likely to take an active role in the care of their units, and may even invest their own funds in maintenance and upgrades. Also, residents who plan to buy their units are less likely to move out. This helps maintain high occupancy rates for the duration of a project, minimizing vacancy losses and related expenses.

Co-op conversion

Conversions of projects to housing cooperatives after Year 15 can also be an option to preserve continued affordability. Housing cooperatives are corporations in which each resident is a shareholder. This gives real ownership and control to tenants through an elected board of directors. Because members have input into the long-term direction of the co-op, this transition strategy can ultimately increase the stability of a community, encourage continual improvement, and reduce operating expenses, turnover and crime.

When investors and developers consider co-op conversions, there are a number of factors to keep in mind, including the amount of debt on the property, property rehabilitation needs, and sources of loans for tenants who wish to finance their units.

Condo conversion

Across the country, more and more residents are being priced out of neighborhoods as a result of booming real estate markets. The multifamily industry has recently capitalized on this

trend by converting more than $1.6 billion worth of apartments into condominiums in the first five months of 2005 alone. This opt-out provision that developers can take advantage of after Year 15 makes the condo conversion option more attractive to profit-motivated developers as the market continues to heat up.

However, this trend also presents a valid opportunity to address sustainability solutions for affordable housing. The potential of converting an LIHTC property into mixed-income condos is intriguing.

To make this approach feasible, some of the units in a project may have to be sold at market rates to enable the sale of other units to low-income buyers. Nonprofits may want to consider these options as well. In an effort to preserve affordable housing, the transition of LIHTC properties to condominiums or co-ops warrants further exploration.

Conclusion

For ESIC, the goals are to deliver an investor's projected return and to preserve affordability by transferring those properties sponsored by nonprofit organizations directly to those groups. ESIC has transitioned 22 projects to date, with an additional 78 projects eligible for disposition through 2007. As partners work through the disposition process for an increasing number of LIHTC projects, an effective exit strategy combined with well-considered options to sustain affordability ultimately benefits all. ■

John Brandenburg is managing director of asset management at Enterprise Social Investment Corp. (ESIC). He manages ESIC's activities related to ESIC portfolio performance and property disposition. If you'd like additional information on Year 15 dispositions, please contact John Brandenburg at (410) 772-2554.

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The law also expands the number of events that would give tenants the right to buy their buildings, and it allows tenant associations to transfer their purchase rights to a third-party developer.

In addition, the state's housing task force this year made preservation a top priority for the next three years.

The Illinois Housing Development Authority continues to have a $3 million set-aside for preservation projects in its QAP.

Massachusetts

MassHousing's QAP sets aside 40% of its tax credits for the preservation of affordable housing. This category includes both federally and state-assisted housing, as well as HOPE VI projects.

MassHousing also refinances existing properties that use HUD-subsidized mortgages where 20% of the units must remain affordable to households earning no more than 80% of the area median income (AMI), or no more than 50% of AMI if HUD risk-sharing is used for credit enhancement.

The Massachusetts Housing Partnership Fund, a quasi-public lender, is another good source for preservation financing, said LISC's O'Donnell. It has closed a number of preservation transactions with primary mortgage loans and no additional credit enhancement.

Unfortunately, the state has terminated its Capital Improvement and Preservation Fund, which helped preserve 2,600 units of affordable housing. Since 2002, the program had committed more than $31 million to affordable housing. The state Department of Housing and Community Development said that it intends to focus exclusively on expanding the housing supply. ■

Tenant ownership provides viable options

By John Brandenburg

The low-income housing tax credit (LIHTC) has helped make affordable housing a reality for millions of Americans. However, the major tax benefits that make LIHTC projects attractive to investors are fully realized in 15 years. Then what?

For projects with credits allocated after 1989, federal law mandates that affordability must be extended for at least another 15 years. A provision in the Internal Revenue Code allows a developer to opt out of the extended-use requirement for a particular project, with state approval, if the state is unable to find a buyer at a formula price (see *Affordable Housing Finance*, July 2004, page 34, and September 2004, page 56).


John Brandenburg

And by Year 15, most investors are looking for exit strategies. Nonprofit developers, however, seek solutions to sustain affordability.

A number of disposition options are available to LIHTC partners, including selling a property to the developer, which may continue to operate it as affordable housing; transferring the property to a charitable organization or government entity; or finding investors to reinvest in the property by using new tax credits to upgrade it for the next 30 years. Federal law allows nonprofit organizations, tenants, tenant co-ops, or government agencies the right of first refusal to purchase properties at a bargain price. If adequate financing is feasible, this can be a winning strategy for everyone.

Selling properties to residents represents another viable option. There are several strategies that allow for resident ownership, including lease-purchase agreements, cooperative (co-op) conversions, and condominium conversions.

Lease-purchase agreements

In some cases, projects are designed from the beginning for eventual sale to residents. These projects are set up under a lease-purchase concept, with the understanding that residents will buy their units when the project reaches Year 15.

> LEASE-PURCHASE PROGRAMS OFFER A TANGIBLE BENEFIT TO LOW-INCOME RESIDENTS: THE OPPORTUNITY FOR HOMEOWNERSHIP.

The Cleveland Housing Network (CHN) pioneered this strategy when the LIHTC program was in its infancy. In January 2005, CHN and The Enterprise Social Investment Corp. (ESIC) began transitioning the latest group of 50 homes, which were developed in 1990, and expect to sell 90% of these units to residents.

Lease-purchase programs offer a tangible benefit to low-income residents: the opportunity for homeownership. These residents are more likely to take an active role in the care of their units, and may even invest their own funds in maintenance and upgrades. Also, residents who plan to buy their units are less likely to move out. This helps maintain high occupancy rates for the duration of a project, minimizing vacancy losses and related expenses.

Co-op conversion

Conversions of projects to housing cooperatives after Year 15 can also be an option to preserve continued affordability. Housing cooperatives are corporations in which each resident is a shareholder. This gives real ownership and control to tenants through an elected board of directors. Because members have input into the long-term direction of the co-op, this transition strategy can ultimately increase the stability of a community, encourage continual improvement, and reduce operating expenses, turnover and crime.

When investors and developers consider co-op conversions, there are a number of factors to keep in mind, including the amount of debt on the property, property rehabilitation needs, and sources of loans for tenants who wish to finance their units.

Condo conversion

Across the country, more and more residents are being priced out of neighborhoods as a result of booming real estate markets. The multifamily industry has recently capitalized on this

trend by converting more than $1.6 billion worth of apartments into condominiums in the first five months of 2005 alone. This opt-out provision that developers can take advantage of after Year 15 makes the condo conversion option more attractive to profit-motivated developers as the market continues to heat up.

However, this trend also presents a valid opportunity to address sustainability solutions for affordable housing. The potential of converting an LIHTC property into mixed-income condos is intriguing.

To make this approach feasible, some of the units in a project may have to be sold at market rates to enable the sale of other units to low-income buyers. Nonprofits may want to consider these options as well. In an effort to preserve affordable housing, the transition of LIHTC properties to condominiums or co-ops warrants further exploration.

Conclusion

For ESIC, the goals are to deliver an investor's projected return and to preserve affordability by transferring those properties sponsored by nonprofit organizations directly to those groups. ESIC has transitioned 22 projects to date, with an additional 78 projects eligible for disposition through 2007. As partners work through the disposition process for an increasing number of LIHTC projects, an effective exit strategy combined with well-considered options to sustain affordability ultimately benefits all. ■

John Brandenburg is managing director of asset management at Enterprise Social Investment Corp. (ESIC). He manages ESIC's activities related to ESIC portfolio performance and property disposition. If you'd like additional information on Year 15 dispositions, please contact John Brandenburg at (410) 772-2554.


YEAR
15

Countdown to Year 15

Lease-purchase programs make sense for affordable housing investors

JOHN BRANDENBURG, ESIC

Affordable housing has come a long way in the past 19 years. The sea change began in 1986, when Congress enacted the Low Income Housing Tax Credit (LIHTC) program as part of the Tax Reform Act of 1986. This new law provided investors with an unprecedented opportunity to do good work while still making a reasonable return on their investment – by putting their money into affordable housing.

The LIHTC program allows investors in qualified rental housing to take credits on their tax returns. The credits are spread over 10 years, and can be worth up to 90 percent of the total investment made in construction or renovation. This fundamentally changed the business case for affordable housing. Through the tax credits, the federal government was providing a tangible means of offsetting investor fears of low returns on their investment in affordable housing.

In exchange for these incentives, the federal government requires that a project remain affordable for 15 years. The program also requires that investors continue to own the project for this 15-year period unless the investor posts a bond to guarantee that the affordability requirement will continue to be met. And for projects that received tax credits after 1989, federal requirements extend housing affordability for an additional 15 years, for a total of not less than 30 years. However, investors could sell their interest in the project after the initial 15-year period of ownership without posting a bond.

But what happens when Year 15 arrives? That's the big question for many investors and developers now that properties are reaching the Year 15 milestone.

Nobody can doubt the results of the LIHTC program. Over 1.6 million affordable housing units have been built nationally since the inception of the program, and nearly 100,000 units are built every year, with an annual investment of over $6 billion. The socially motivated for-profit and non-profit developers are able to sell the tax credits to investors to raise the equity needed to build or renovate the affordable housing.

But by the time Year 15 arrives, the tax benefits associated with a project have been exhausted. At this point, most investors are interested in ending their involvement in projects and focus their resources on new projects or on other ventures. For these investors, there are a number of disposition strategies that they can employ. These include selling the property to the developer to continue to operate as affordable housing, selling the property to a charitable organization or government entity at a bargain price, or finding new investors to reinvest in the property with new tax credits to upgrade it for the next 30 years. There are several other options that have varying degrees of appeal.

And then there is the innovative option that creates homeownership opportunities for tenants in projects funded by a program that what was originally structured only to provide affordable rental housing. Under this option, residents are given a chance to buy their units at the end of the 15-year compliance period.

If the project consists of single-family homes, the units can be sold directly to the individual tenants at a very affordable price. Alternatively, multifamily properties can be transferred to a tenant-sponsored cooperative, or a condominium association could be formed to acquire the property. By selling to the tenants through one of these means, the goals of fostering homeownership and enhancing community stability can be achieved.

In some cases, projects were planned from the beginning ultimately to be sold to their low-income tenants. Projects were set up under a "lease-purchase" concept, with the tenants understanding from the beginning that they would be able to buy their units when the project reached the 15-year milestone. Lease-purchase programs can be sound business strategies for developers for a number of reasons. Developers are responsible for day-to-day oversight of LIHTC properties (or at least for hiring apartment professionals to manage the properties), and a

lease-purchase exit strategy provides significant operational benefits that begin on Day One and last for all 15 years of a project's lifecycle. Lease-purchase programs can positively impact everything from occupancy rates to maintenance costs to renter profiles.

For instance, residents who plan to buy their units tend to be more likely than typical renters to take care of their unit, and may even invest their own funds in maintenance and upgrades. Lease-purchase programs also help attract responsible residents who want to improve their lives. And the carrot of affordable home ownership encourages long-term rentals, as residents who plan to buy their units are less likely to move out. This helps sponsors maintain very high occupancy rates for the duration of a project and minimize vacancy loss and expenses.

CHN: Pioneers in Lease-Purchase

In 1987, the Cleveland Housing Network (CHN), a partner with my firm, The Enterprise Social Investment Corporation (ESIC) in 20 separate projects, linked the Low Income Housing Tax Credit to a lease-purchase option for residents in several projects. To date, CHN has assisted 2,100 low-income families in Cleveland, Ohio move up and out of poverty, thanks in large part to the stability and wealth created by affordable home ownership.

CHN's program is built upon a long-standing "hand up" strategy that promises eventual homeownership after 15 years of responsible residency. Since its inception, CHN has leveraged over $120 million in direct capital investment in Cleveland's neighborhoods. The program is specifically designed to keep monthly payments for residents as low as possible.

In January 2005, CHN began selling its latest group of 50 lease-purchase homes, which were developed in 1990 and reached the Year 15 milestone in 2004. CHN expects to succeed in selling 90 percent of these units to lease-purchase residents.

Conclusion

The business of affordable housing has changed dramatically since the nation's first LIHTC project was completed in Pittsburgh 17 years ago. ESIC has raised more than $4.7 billion in LIHTC equity since 1987, and orchestrated the investment of these funds in over 1,200 projects providing over 65,000 apartments and homes affordable by low and moderate income households. ESIC is currently undertaking over 120 projects annually. From the outset, ESIC's intention has been that projects sponsored by non-profit corporations would be sold to their non-profit sponsor after the end of the 15-year compliance period to avoid potential low-income tenant displacement or loss of affordable housing options, and also to create affordable homeownership opportunities.

As the LIHTC program celebrates its 19th birthday, many projects initiated in the early days are coming to Year 15. ESIC's first three projects hit Year 15 in 2002, and through 2004 ESIC has transferred 17 projects to their non-profit sponsors. By 2007, that number will have grown to over 80 projects, and it's heading higher in the coming years, ultimately reaching over 100 projects annually.

The issue of Year 15 is here to stay and will continually evolve as developers and investors think through their exit strategies. Giving families the opportunity to improve their lot in life through homeownership is one way that the LIHTC program is furthering the goals of community stability and also giving low-income tenants a chance to share in the American dream.

Developers, investors and housing professionals interested in learning more about the Year 15 issue can visit www.esic.org. **AP**

AUTHOR: John Brandenburg is managing director, asset management, at ESIC. He manages ESIC's activities related to project performance, problem resolution and property disposition.

How Big is Your (Rule of) Thumb?

The Fallacy of Conventional Capital Funding Assumptions

It is widely held that **$300 - $360 per unit per year** is an adequate replacement reserve funding level for an affordable housing development.

This is what it actually gets you -

Item	Amount	Unit cost	Per apartment	Useful Life	Annual cost
Carpet	600	$ 2.00	$ 1,200.00	10	$ 120.00
Refrigerator	1	$ 450.00	$ 450.00	15	$ 30.00
Stove	1	$ 300.00	$ 300.00	20	$ 15.00
Counter	1	$ 250.00	$ 250.00	10	$ 25.00
Kitchen Floor	1	$ 150.00	$ 150.00	15	$ 10.00
Bath Floor	1	$ 150.00	$ 150.00	15	$ 10.00
Water Heater	1	$ 300.00	$ 300.00	10	$ 30.00
Cabinets	1	$ 2,400.00	$ 2,400.00	20	$ 120.00
					$ 360.00

Our experience is that **two thirds** of all existing affordable properties fund reserves at **$360 or less.**

For them, one had better hope that -

The roof will never leak

The paint job lasts forever

Building siding is everlasting

No potholes will ever develop in the parking lot

No one will ever need a furnace or air conditioner

All windows will work forever

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CHAPTER FIVE

Capital Needs Assessments

Edward J. Daly and David Whiston

What is a Capital Needs Assessment?

Capital needs assessments (here called CNAs) are also known as Physical Needs Assessments (PNA), Physical Condition Assessments (PCA), reserve studies (typically for condominium associations), HUD Comprehensive Needs Assessments (CNA) or capital plans. These terms are sometimes used interchangeably, though they often refer to very specific products. They all share a common basis: a report on a property which estimates its repair and replacement needs over an extended period of time, often analyzing the way in which resources need to be accumulated to pay for these needs (reserve analysis).

Identifying Capital Needs of Aging Properties – Why Bother?

CNAs act as valuable management and investment tools for both non-profit and for-profit real estate owners and managers. A property owner should consider conducting a CNA when a property has significant physical problems in order to put these existing problems in perspective against other ongoing needs and future needs of the property. A leaky roof may be an expensive problem to fix, but the ongoing need to replace refrigerators when they fail will remain. Additionally, an aging boiler can't be expected to last forever, even if it works well today.

Increasingly, public agencies and other lenders require a CNA as part of the underwriting process for the acquisition, financing or recapitalization of existing properties. They may also require a periodic CNA as a normal part of asset management procedures. These CNAs are designed not only to ensure the adequacy of any proposed rehabilitation, but also to set appropriate replacement reserve levels going forward.

CDCs and other housing providers have successfully used high-quality CNAs to bolster the case for additional resources (loans and grants) or reallocation of funds to reserves which can be shown to be inadequate.

Conducting a CNA when pressing physical problems don't exist can be helpful in avoiding unpleasant surprises, such as a boiler failure on New Year's Eve. If an owner can anticipate that a building's boiler has five to seven years of useful life remaining, they can accumulate funding to pay for the expense and schedule the replacement in the summer when the boiler is not in use. This should lower the cost and avoid consequential damages to the building and its residents.

A high-quality CNA can help property owners keep abreast of evolving code issues such as life safety, energy conservation and handicapped access. The standards set by these codes may either be mandatory or simply present opportunities to improve the property, but should be considered when assessing the building's needs. A thoughtful CNA will help avoid a mistake such as renovating the community room kitchen without incorporating the required accessibility features.

A high-quality CNA will help the owner of affordable housing operate its properties with an eye to local market standards. Even in areas that lack enough affordable housing, competition within the subsidized housing market may exist. High vacancy rates and even abandonment have been seen in both urban and rural communities due to competition from newer subsidized properties.

A high-quality CNA can also help guide spending decisions by laying out the long-term or life cycle costs of various materials. Looking at twenty years of costs can help assess whether a more expensive, but also more durable, option can turn out to be less costly in the long run.

Most importantly, a high-quality CNA contains an integrated analysis of replacement reserve accounts. This allows the CDC to plan for the future in light of known resource allocations. It is helpful to know that all the roofs will need to be shingled twelve to fourteen years from now and that the cost will increase projected capital spending in those years from $8,000 per year to over $40,000. But if the study doesn't reveal whether the reserves will be able to pay for the work or how much the CDC needs to increase annual contributions to reserves, the CNA has left out a key component.

For many owners and regulators, the most important aspect of a comprehensive capital plan is the analysis of the adequacy of the replacement reserve fund. If potential future shortfalls in funding can be anticipated, they can often be avoided with only marginal near term increases in annual contributions to reserves. This hypothesis is confirmed by an analysis of 183 multifamily properties conducted by On-Site Insight, Inc. (OSI).

The properties in OSI's sample included family and elderly developments in urban and rural locations in eighteen states. Properties ranged in size from six to 775 units and ranged in age from one to 35 years. Sixty-five percent of the properties were more than twenty years old.

As Figure 5.1 shows, only seventeen percent of the properties in this sample had enough internal resources (initial reserve for replacement and stream of annual contributions to reserves) to pay for all of their anticipated capital needs. While this reflects an unfortunate lack of attention to long-term property management, the chart also shows that a large number of properties could have been made "healthy" with modest adjustments in reserve funding. With another $120 per unit per year in annual contributions to reserves, an additional eleven percent would be adequately funded. With up to $360 per unit in additional annual contributions, a further twenty three percent could be put on a sound footing. The complete study can be found at www.on-site-insight.com/hudemo.htm.

A Cautionary Note About "Rules of Thumb"

Property owners and lenders often use a standard rule of thumb for allocating annual contributions to reserves. For many years people in the industry have been using something on the order of $360/unit/year ($30/unit/month) as a guideline. This in fact was the first standard used by the Massachusetts Housing Finance Agency (MassHousing) when it began requiring reserve studies in the mid 1980s.

The table on page 30 lists some relatively short-lived items found in nearly all apartments with some standard quantities and unit costs. If one applies an expected useful life to each, one can then determine the annual "cost" or the annual contribution needed to reserve for the items when they are new.

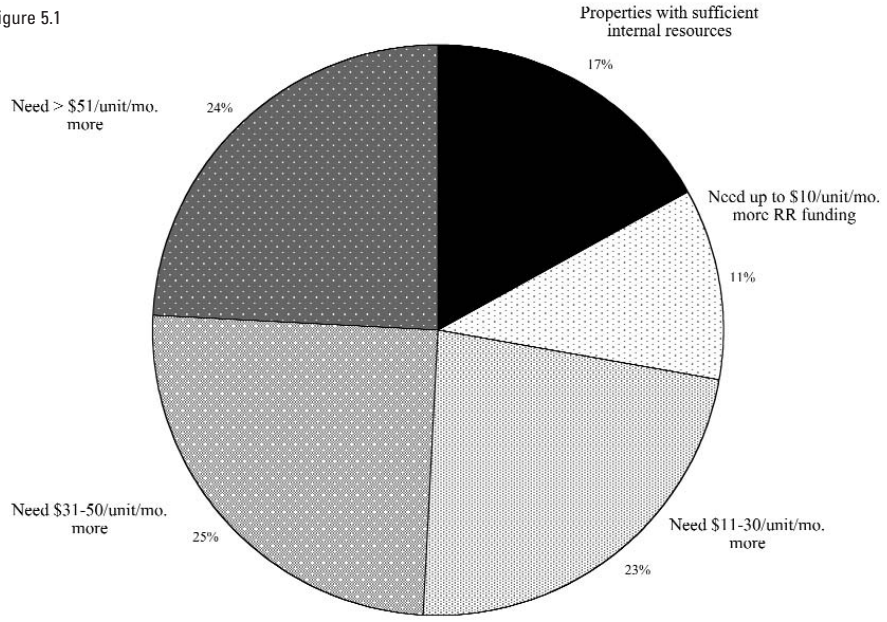
That is, if the average unit has 600 square feet of carpet which costs $2.00 per square foot (installed) and is expected to last ten years, then the owner should be saving $120 every year to fund its replacement.

As the table shows, eight in-unit items alone will consume all of the $360 per unit rule of thumb in this hypothetical property. This would leave nothing for the remaining in-unit components (such as paint, doors, and fixtures) and nothing for roofing, siding, heating and air conditioning, window and door replacement, parking and grounds repairs, or anything else the property will need in the long run.

If the "rule of thumb" is so inadequate, and considering the underfunding found in the study cited above, one

Distribution of sample by relative "health"

Figure 5.1



Item	Quantity	Unit Cost	Total Cost	Expected life Useful Life	Annual Cost
Carpet	600 sf	$2.00	$1,200	10 yrs	$120.00
Refrigerator	1 ea	$450.00	$450.00	15 yrs	$30.00
Stove	1 ea	$300.00	$300.00	20 yrs	$15.00
Cabinets	1 ea	$2,400.00	$2,400.00	20 yrs	$120.00
Countertop	1 ea	$250.00	$250.00	10 yrs	$25.00
Kitchen Floor	1 ea	$150.00	$150.00	15 yrs	$10.00
Bath Floor	1 ea	$150.00	$150.00	10 yrs	$15.00
Water heater	1 ea	$300.00	$300.00	10 yrs	$30.00
Total Annual cost for These Items					**$365.00**

could reasonably wonder how could all these properties have survived over the years. The real-life pressures on owners and managers have forced them to operate with inadequate capital budgets. Many owners and managers report funding capital improvements from the operating budget, if this resource exists. Sometimes repairs are made instead of replacement, as when managers patch a hollow core door instead of replacing it. Most often, needed work is simply deferred as long as possible. Painting is done every ten years instead of every five; double-glazed windows with failed seals are not re-glazed; torn or burned carpets are not replaced. These deferrals can lead to other larger problems (unpainted trim begins to rot, for example) but at the very least they begin to affect a property's marketability and value.

This is not to imply that most affordable properties are physically distressed and only marginally marketable. What is clear is that many CDCs and others are spending from reserves as fast as they are making annual contributions, leaving the reserves too thin to cover major costs.

History of Capital Planning in HUD-Assisted Multifamily Housing

Capital planning as it is known today began with a HUD-sponsored study of public housing in 1983. This study (MODUSA) came out of a Congressional mandate to conduct a sample survey of all Public Housing and Indian Housing Authorities nationwide to determine the backlog of modernization needs. Congress ultimately never funded the backlog, but the study did lead eventually to some improvements in the HUD capital allocation system. It also led to the "observable systems" approach to multi-family building inspection.

In 1986/87 MassHousing became concerned that its portfolio of multifamily properties might be putting its bond rating at risk if future repair and replacement needs were not properly funded. The portfolio exceeded 400 properties statewide, with a total unit count in excess of 50,000. In 1988 they directed the private owners of these subsidized developments to prepare and submit 20-year capital needs assessments to MassHousing in a standard format, including unit cost estimates, expected useful lives, and inflation rates that were item specific. MassHousing then analyzed whether a simple trending of current annual deposits to the property's dedicated reserve for replacement account would be adequate to support the spending plan. Significantly, very few properties (even in this well-built and well-run portfolio) could pay for all anticipated capital requirements (without upgrades) from existing resources. Some real-estate consulting firms developed models that would also analyze replacement reserves on an annual cash-flow basis.

This approach to asset management spread to several other state housing finance agencies, including Rhode Island (RIHMFC), Virginia (VHDA), Connecticut (CHFA), Michigan (MSHDA), New York and New Hampshire. The implementation varied widely. Most agencies could not impose this requirement on owners, but did require such a study as part of any application for rent increases, for a change in annual contributions to reserves, or any financial re-structuring. MassHousing required all owners to submit reports at least twice, and still requires or commissions reports on a regular basis.

In 1990 the Federal National Mortgage Association (Fannie Mae) established consistent standards for the private lenders operating under its authority when conducting due-diligence on the underwriting of multi-family loans and refinancings. Fannie Mae developed a uniform framework for capital needs assessments. This consisted of three components:

1. A set of reporting forms capturing the items to be evaluated, their age, expected useful life, replacement cost and repair/replacement timing;
2. A table of expected useful lives for hundreds of components, which distinguishes between family and elderly developments.

3. A narrative "Guidance to the Evaluator" which described the approach to inspection and instructions on analysis and completion of the forms.

The Fannie Mae forms aggregate and trend costs on a year-by-year basis, but do not provide for any replacement reserve analysis. They have become extremely valuable to the Fannie Mae Delegated Underwriting and Servicing (DUS) lenders and have been made available for HUD's use in the Mark to Market program.

In the late 1980s, HUD was faced with managing hundreds of transactions that were triggered by the right of owners nationwide to exercise their contract rights to pay off HUD mortgages and convert developments to market rate use. The Low Income Housing Preservation and Resident Homeownership Act (LIHPRHA) "preservation" program was designed to preserve affordability, while allowing owners access to built-up equity. Every property that participated in the program underwent a Preservation Capital Needs Assessment (PCNA) aimed at understanding current repair and replacement needs and determining an appropriate lump sum deposit to reserves to meet reasonably anticipated future needs. HUD contracted directly with real estate consultants and others to conduct PCNAs. These PCNAs were adequate snapshots of current conditions, but very poorly designed to capture the future needs on a year-by-year basis.

In 1995 HUD established the Comprehensive Needs Assessment program. This general assessment tool focused on properties not eligible for LIHPRHA. It attempted to quantify current and future needs and the resources (both at the property and from outside sources) available to pay for repairs. HUD required owners to hire third-party contractors to prepare the CNAs. The program eventually made a huge breakthrough in clarifying HUD's intentions regarding enforcement of handicap accessibility requirements required by Section 504 of the Rehabilitation Act of 1973.[1] Major drawbacks were the definitions of line-item reporting categories (e.g., windows and doors are lumped together) and the aggregation of time periods (Years 2 through 8 are combined in a presumed 20 year planning period). The program also lost focus when considerations of social service needs and the like were appended onto the reporting requirements for capital improvements.

One major current HUD program involves trying to reduce future Section 8 subsidy obligations to assisted properties without losing the affordability restrictions. When Section 8 rents exceed market levels at the time of contract renewal, the property may be subject to subsidy reduction and debt restructuring as a condition of renewal under HUD's Mark to Market (M2M) program. M2M requires HUD's private sector agents (Participating Administrative Entities, or PAEs) to hire consultants to prepare physical needs assessments using the Fannie Mae model discussed above. The M2M guidelines establish inspector credentials, mandate consultation with tenants, categorize needs by immediacy and severity, require attention to accessibility and environmental concerns, and require evaluation of market-comparable upgrades identified by an appraiser. The responsibilities of HUD's Office of Multifamily Housing Assistance Restructuring (OMHAR) have been transferred to the new Office of Affordable Housing Preservation (OAHP), which will continue to accept applications for the Mark to Market program until September 30, 2006.[2]

Section 202 Recapitalizations

The newest use of CNAs has been in the recapitalization of older Section 202 developments. This program, created by the Housing Act of 1959, provides direct loans to non-profits to develop and rehabilitate multifamily properties for the elderly and disabled. In the late 1970s Section 202 loans were linked to Section 8 subsidies to assure affordability to low-income residents. The older properties have both aging building components and, increasingly, frail elderly residents who would prefer to remain in place. Recapitalization of these properties recognizes the need to replace durable, long-lived systems like roofing, windows, and mechanical systems, while adapting common areas and units to the requirements of seniors and persons with disabilities. One strategy used by sponsors is to combine tax-exempt debt, Fannie Mae credit enhancement, and equity from Low Income Housing Tax Credits (LIHTC). Bond regulations and tax credit rules may specify a minimum up-front rehabilitation cost per unit. CNAs in this context need to balance current and future needs with extraordinary sensitivity to the requirements of these third-party interests.

A Word About REAC

One of the major multifamily initiatives that has come out of HUD in the past five years has been the use of a new basic physical inspection system under the auspices of the Real Estate Assessment Center (REAC). These inspections are conducted using hand-held computers to evaluate subsidized properties based on a

newly-developed Uniform Physical Conditions Standard (UPCS). Although designed for regulatory purposes, these inspections might in some cases give a property owner useful guidance about current physical deficiencies, but they have no forward-looking component. At best, a REAC/UPCS score is a snapshot of current conditions.

Components of a Well-Designed Capital Plan

How will a CDC know whether the sample report they are looking at is a high-quality one? How will a nonprofit know whether they got real value for the investment in the planning study they just commissioned?

An effective capital plan is composed of the following elements:

- The inventory component needs to include all of the systems, not just those which require attention now or in the near future. An item that has recently been replaced, and may not be expected to need attention again for the next twenty years, should still be listed for reference. If the assessor has made an assumption that a particular item represents an operating cost concern, the analysis should be shown to facilitate discussion and remediation.
- Each system or item included needs to have its age identified. In older properties, ages of components may not coincide with the development's age. Ages may vary widely between items and even across a single item. Unit flooring may have been installed over a five-year period which began eight years ago.
- Expected useful life estimates are the key to replacement timing. Capital planning is built on the idea that even systems that operate properly now will eventually fail. Expected lives should be adjusted from the norms found in various tables to the actual conditions at each development. Expected lives should be adjusted for climate, original materials and installation, maintenance practices, and resident demographic profiles. For example, elderly and family occupancy present different issues.
- Cost estimating is the hardest part of capital planning. The consultant should have access to good costs adjusted for the local area. The ability to adjust costs for individual building circumstances and the relative purchasing power of the CDC is equally important.
- A year by year cost summary of all of the anticipated capital needs will show not only how much needs to be spent but when. A relatively steady level of expenditures is much easier to anticipate than one with large swings. While a steady level may be desirable from a financial viewpoint, peaks and valleys might more accurately describe the real needs of the property, especially at single-building developments.
- Narrative presentations are usually necessary to describe the current condition, the maintenance history, and the rationale behind the consultant's cost and timing decisions. Narratives allow for a description of the cause of current problems, details on location of problems, or discussion of alternatives like rebuilding a pump motor instead of replacing the whole pump.
- Photographs can be invaluable tools when the report has a non-technical audience or is shared with a third party like a lender or regulator. These readers may never have been in a boiler room or crawl space. They may be unfamiliar with technical terms. Photographs can also support the findings and recommendations of the consultant. Showing the extent of the siding damage or the width of the foundation cracks can overcome a lot of resistance.
- Accessibility is not just good marketing, it is the law. All properties receiving direct federal financial assistance should have made common areas fully accessible a decade ago and need to have a plan for making units accessible as required. A useful capital plan integrates any accessibility needs with the other work required.
- Most importantly, in order to be useful, the CNA must evaluate existing capital reserves and annual contributions to reserves against the long-term spending plan. Only this analysis will let the CDC know the optimum annual contribution to reserves in a way that can be convincingly presented to others. The reserve plan should reflect real life constraints that are at odds with making the "optimum" contribution.

Formats for Capital Plans

HUD Formats

In the LIHPRHA and ELIHPA Preservation programs, HUD required reports attempting to establish the value of the property by deducting the cost of immediate needs. This approach lacked the needed focus on long-range planning. The format had adequate specificity about work to be done and location, but used a cost form (FHA Form 2326) designed around trade divisions. These plans often concealed as much as they revealed. The reserve analysis only accounted for the first time

anything needed to be replaced. This underestimated the need for short-lived items like unit carpet and refrigerators. It did not include the cost of accessibility improvements and ignored future inflation.

HUD's Comprehensive Needs Assessment (HUD CNA) format, still in use by some HUD offices, was limited by a planning spreadsheet that grouped costs into broad ranges like "Years 9-15" and into broad categories like "Hot water and boiler systems." However, it did mandate significant discussions of resident needs, accessibility deficiencies, and potential outside resources which might be tapped to pay for capital costs.

M2M and Fannie Mae

One widely known format for CNAs is contained in the Fannie Mae Physical Needs Assessment Guidance to the Property Evaluator. As noted above, this document was developed for Fannie Mae for use by that agency and its lenders. Subsequently it was licensed for use in HUD's M2M program. This format and the accompanying guidance forces the evaluator to look at a relatively large number of discrete items and allows for the evaluation and recording of unlimited other items. It forces the evaluator to be explicit about expected useful life assumptions and establishes some norms for evaluating useful life. Its major limitation is that it does not analyze the adequacy of replacement reserves. [3]

ASTM Baseline Property Condition Assessment Process

This Standard has been issued by ASTM International (formerly The American Society for Testing and Materials) to "define good commercial and customary practice…for conducting a baseline property condition assessment" for both multifamily residential and other commercial properties. It does not include any spreadsheet models or reserve analysis. It references the Americans with Disabilities Act (ADA) as the accessibility standard and not Section 504/Uniform Federal Accessibility Standards. While ADA covers accessibility standards for places of public accommodation, unlike Section 504 Standards, it does not cover dwelling units. Recipients of Federal funds are required to follow Section 504 Standards. While designed initially for commercial properties, it has been used in some housing evaluations. The ASTM Standard allows for sampling not only of dwelling units, but allows for "representative observations" of all systems and buildings, which in some instances may overlook important information. This is a significant potential limitation.

All of the major national formats focus on costs—sometimes only immediate needs and sometimes longer-term. The HUD CNA format attempted to make the critical connection between costs and resources, but its utility is limited by the focus on social concerns and the awkward categories. Some state housing finance agencies, notably MassHousing, have developed formats which do evaluate annual cost totals against a stream of annual contributions to reserves. They require CNA consultants to aggregate all costs to an annual total, which is compared with the year by year expected balances in reserves. The model accounts for inflation and for interest earned on reserve deposits. Custom formats have also been developed by individual consulting firms. These vary widely in the level of detail and sophistication of analysis.

It is important for any consumer of CNA services to remember that even the most impressive looking format, full of "bells and whistles," is of very little use if the people carrying out the study don't have the skills and support to do it right. CDCs should be very cautious of firms with little housing experience, firms unfamiliar with the building type or local environment, and firms where one team conducts the field work and another develops the analysis.

How to Hire and Manage a Third Party Consultant

Why Use a Third Party?

CDCs often ask why they should go to the trouble of hiring a third party when they have in-house staff with good building skills and staff with good financial skills. There are several things to think about before deciding to conduct an in-house CNA.

Many regulatory agencies and programs like HUD's Comprehensive Needs Assessment and Mark to Market programs require the use of third party consultants. These firms, like appraisers and accountants, provide an independent, neutral evaluation of conditions which is a necessity in due diligence situations. Even when not required, the independence of the assessor can be of value to the CDC when presenting a CNA to a lender or regulator.

A thoughtful needs assessor brings the experiences of other clients to bear in analyzing each property. Property owners gain by exposure to best practices, new products, and specialized skills not found in their organization.

Even if the CDC has staff with the skills to produce a CNA, it may not be the best use of their time, especially if there is a large portfolio to evaluate. An independent assessor can be expected to accomplish the task more quickly than relying on the "spare time" of the property managers, superintendents, and office staff.

If a CDC does decide to undertake the process itself, remember that the work will require:

- A through field evaluation tool covering all systems in a consistent manner;
- Staff with 40 or more available hours to see it through;
- Building technology skills covering both architectural and mechanical systems;
- A truly objective point of view, even if that leads to questions about things like staffing or past rehab decisions;
- A reliable source of cost and useful life data (RS Means, Marshall and Swift); and
- A detailed cost estimating and financial analysis spreadsheet model.

How to Select a Firm

There are a growing number of firms providing CNA services to residential and commercial property owners. These include architectural or engineering firms, environmental site assessment firms, home inspectors, and real estate consulting firms dedicated to capital planning. Some use in-house staff, some rely heavily on subconsultants, and some use a network of "affiliates" or stringers to do the fieldwork.

As in the choice of any professional consultant, the owner needs to be concerned with the technical qualifications, the experience, and the competence of the consultant. In choosing a CNA vendor, the owner ought to ask some additional questions.

Who does mechanical systems evaluations? Many multifamily buildings have a variety of sophisticated and expensive mechanical and electrical systems like boilers for heat and hot water, central air handling equipment, elevators, and fire alarm systems. The evaluation of the adequacy, efficiency, and expected useful lives of this kind of equipment requires specialized skills. This work is beyond the capacity of the layman and even outside the skill set of most architectural firms. Because mechanical and electrical equipment is critical to operations and life safety and because the cost of replacing the systems is both so high and typically cannot be spread out, having strong mechanical evaluation skills on the assessor's team is critical.

Is the format accessible to all constituencies? When management commissions a CNA it is important that the resulting report have as much utility as possible. If it is to be submitted to a lender or regulator, it must of course meet the minimum standards set by the third party as with the M2M program or Fannie Mae DUS lending programs. But this is only the beginning. In order to have the most value to the owner, the report must be a useful tool in itself. Ask to see a sample report for a property like the one under consideration and ask the following questions:

- Does it have a readable, project-specific narrative section, or does it all sound like boilerplate?
- Does it have a cost estimation summary that clearly states the expected costs over the planning period (typically 20 years)?
- Does it contain detailed quantities or is everything on a per unit or lump sum basis?
- Does the format allow for sufficient customization or do the hallway doors, the closet doors, the entry door, the service doors and the roll-up garage door all get lumped together under "Doors"?
- Are there charts and graphs to aid understanding and simplify presentation to others?
- Are there color photos to document and clarify the findings?
- Can a third-party reader, like a lender, envision the property itself from the combination of narrative, photos and spreadsheets?

A helpful CNA is not only accessible to the Director of Maintenance and the financial team, but should be clear enough for the CDC's Board of Directors to understand and detailed enough to be useful to the building superintendent.

Can the assessor think about maintenance as well as capital concerns? In order to maximize the value to the owner, the CNA consultant should have a process and a product that helps improve maintenance, especially of complex and expensive mechanical systems. It is not enough to state that the circulating pump has failed after five years when it was expected to last fifteen years. An experienced consultant should be able to distinguish between a poorly sized pump, a poorly made or installed pump, and a poorly maintained pump. All three can cause premature failure, and before buying a new one management should know why the first one failed.

Can the consultant produce multiple scenarios and adjust variables? Long range planning always involves some unknowns. How fast will prices for repair and remodeling rise in the next twenty years? At what rate will rents rise given market forces, regulatory restraints and the goals of the CDC? What sort of rate of return can be expected on the replacement reserve account? No matter how good the inventory, cost estimates and expected life projections of the plan are, variables like this can make a big difference in the long-term financial stability of the property. Can this consultant advise about appropriate levels and can he or she show alternate plans based on the same set of known conditions?

Is price important? Of course price is important, but the owner should ultimately be concerned about value. A low-cost CNA that requires several rounds of negotiation with the lender or regulator uses time and energy that could better be used elsewhere. A low-cost CNA which calls for brick pointing but is silent on the underlying causes of the cracks can lead to false security about the building as a structure and as an asset. A low-cost CNA which contains only tables of numbers provides little in the way of support for board presentations or guidance to site staffs. Price is one element of value, but so is the quality of the product.

One way to reduce cost is to be able to provide the most support to the consultant (see below). Another strategy is to bundle a number of properties, or the whole portfolio, into a single contract. This is especially effective if the consultant is from out of town and needs to include the direct costs of travel and lodging in the fee.

How to Get the Most out of the Consultant Fee

In order to maximize the value of the CNA, the owner must see it as a collaborative effort between the client and the consultant. The collaboration begins before the inspection starts and continues even after the report is finalized. CDCs need to think of the CNA as a process and not just a product.

Before the Inspection

All high-quality CNAs make use of historic information about the property. The assessor will want to know when major work like roofing and boiler replacement was last done (if ever) and will want to know about past replacement of short-lived items like unit carpet and individual domestic hot water heaters. Having this information available in advance or on the day of the inspection will help the assessor evaluate the current condition of the property. It will also help establish future replacement schedules. If records show that all carpets were replaced between 1994 and 1998, and a second round of carpets was begun in 2002, then the assessor can evaluate whether this timing makes sense at this property given the materials, climate, household composition and other factors.

If the CDC can provide the actual costs of these past activities, these will provide one valuable measure on which to base future cost estimates. While there are several reliable third-party cost estimating sources like RS Means, and some consulting firms have developed their own price book, costs for simple items such as a 30 gallon domestic hot water heater can vary widely depending on the market. A CDC with an extensive portfolio and a long history in the community may be able to negotiate a reduced rate from local suppliers. At the other extreme, a nonprofit may have only a small property in a hard-to-serve rural community where they need to pay full retail for appliances as well as the cost for installation. Accurate cost estimates for a specific operation is one key to a CNA that has real value.

Pre-planning should also include finding the architectural plans. While it is possible to produce a CNA without a set of site and building plans, the result will be higher cost, lower quality or both. The service contracts for major equipment like elevators, fire alarms and emergency generators also provide helpful detail.

The interaction during a CNA is not only between the consultant and the owner, but also among the consultant, the owner, and the residents. Management and the consultant should work in advance to select the appropriate unit sample. In some cases this is dictated by a third party. In other cases management needs to make sure that the sample size gives the CDC confidence that all relevant observations are being made. Notifying residents in advance makes the assessor's job easier, minimizes disruption of residents' lives, and avoids problems between property staff and residents.

During the Inspection

The most important assistance the owner can provide during the inspection is the availability of good escorts. The assessor evaluating the mechanical systems should have the property's most experienced mechanical person with him or her. Not only will the assessor be able to ask questions about ages, maintenance practices, operational problems and "What's behind this door?" but the assessor may also

be able to share ideas about how to improve operations or save money without expensive upgrades or replacements. The person inspecting the apartment interiors also needs an escort. Ideally this person should also be familiar with the ages of finishes and equipment, replacement cycles, and typical maintenance practices. To assist the assessor, it is just as important that this escort knows the residents, is known by the residents, and knows the neighborhood if the assignment is for a scattered site property. This will maximize the time the assessor spends actually looking at conditions and minimize the time spent waiting for people to answer the door. Finally, on the day of inspection, make sure that an extension ladder, if needed, is available to provide access the roof. Site escorts should have all the keys they need to electric closets, roof hatches, storage buildings and the like.

Reviewing the Report

Read the report. Really read the report. The CNA may be the key piece of due diligence needed to secure funding for refinancing. Because the process can be costly and only done infrequently, the CNA deserves careful review by all interested parties. Key staff such as the building superintendent, property manager, and CFO should all read the report. After the report is read and understood, the CDC should work with the consultant to adjust the assumptions (such as cost, useful life, and interest rates) based on the organization's knowledge of local conditions and the CDC's own policies.

Follow Up

In choosing a capital-planning consultant, a property owner should make sure that the person who led the field investigation is available to meet with management, either in person or by phone, to go over the report. Be skeptical if the only interaction is with a "report reviewer" and not the inspecting professional. This review meeting is essential in maximizing the value to the CDC. It is at this point that the questions from careful reading get answered. It is here that conflicts between past practice and consultant recommendations get ironed out. This is when additional documentation on ages and actual costs can be presented to be incorporated into the final report. Remember, this is your document – it will only be useful if understood by the property owner, if the information can be communicated to others, and if there is a reasonable chance of carrying out the plan.

Roles of a Planner and Architect or Engineer

While most CNAs done for property management, asset management, or even due diligence purposes do not require the engagement of a registered architect or professional engineer, there are clearly cases where this is appropriate. Licensed professionals are necessary when:

- Structural problems have been identified;
- The use of space is going to be changed, for example by converting apartments to congregate living;
- A building permit is required, or designed solutions are needed.

From time to time, the CNA firm will recommend employing a specialty consultant to work with them on a plan. They may suggest that a structural engineer or elevator specialist work alongside the inspection team if there are specific problems identified in advance. A thoughtful CNA consultant also recognizes when there are problems outside their area of competence and may recommend during or after the inspection that the client engage other professionals either to perform additional destructive testing or to develop a proposal for a design solution.

Capital planning is not the same as design, though the need for a designer may flow from the capital plan recommendations. Alternately, a substantial rehabilitation requiring a design professional may be the catalyst to undertake a capital plan. The different points of view expressed by the planner and the designer may need to be reconciled by the CDC. It is important that the CDC actively understands and manages the interaction between these two professions so as to maximize the value of all of the consulting work.

Sometimes CNA firms are asked to develop long-range plans based on an architect's scope and cost estimates for a major rehabilitation. When the scope is well developed and the cost estimate is broken down by work item, and not just broad categories like "Metals" or "Concrete," this can be a useful way to proceed. If an owner takes this approach, they can expect there to be some give and take among the client and the two consultants. The CNA firm may feel certain elements are being replaced prematurely or that the focus of the rehab plan is on highly visible items while neglecting important infrastructure. Try to remember that the current project is only one event in the life of the building, and that compromises might need to be made in order assure financial stability at the lowest cost over the long term.

Topics for CDCs

The Use of a CNA When Recapitalizing

While CNAs are used more and more for routine property management and asset management purposes, they should be seen as a key component of any recapitalization strategy. Good forensic evaluations of the site, the building envelope, and the mechanical and life safety systems are necessary to produce realistic costs for capital improvements. Using freed up income to pay for the increasing operating costs for insurance, utilities and the like makes lots of sense. Putting some of that money into capital improvements is also a good idea. Putting the right amount of money into the right capital improvements at the right time is not only the goal of the CNA, but will prove most valuable to the CDC in the long run.

Refinancing may be the best (and perhaps the only) opportunity to get significant new capital to apply to physical needs. The CNA should allow the CDC to distinguish between ongoing replacement needs like appliances and carpet and "big ticket" items like boiler replacement, new siding, new windows, or an elevator upgrade.

Some capital items lend themselves to replacement over time. Not all tenants impose the same wear and tear on the appliances. A tired but functional bathroom vanity probably is not going to be replaced until a new tenant moves in. Not all air conditioner compressors will fail at once. An annual stream of contributions to reserves can be set to roughly match the rate of expenditure for work items that can be or should be spread over time.

While air conditioners might best be replaced over a five or ten-year period, other replacements need to be done at one time either because the item is essential to the building's functioning (replacing a leaky roof) or because of economies of scale (replacing old windows). Most of these durable, but expensive items have long useful lives. However, when they fail, they are expensive to replace. If the CDC has been extraordinarily foresighted and has had good relations with a progressive lender and regulator, the property may have been accumulating this needed money in its reserve account. More likely, the CNA will show a shortfall in reserves at the time the major costs are anticipated. They may show up as immediate needs, which certainly should be incorporated into the recapitalization.

What about the case where the big ticket items function adequately now, have some useful life remaining, but are anticipated to need replacement in the next three to five years? Most reserve accounts will be inadequate and not enough time remains for an increase in annual contributions to do much good. This is the opportunity (if there is a high-quality CNA in place) to do one of two things. One choice is to "prematurely retire" that aged but still functioning fire pump, and replace it now with some of the proceeds of the refinancing. The other possibility is to use the proceeds to fund the reserve by an amount equal to the cost of replacing the fire pump when it is expected to fail in four years.

Both strategies have some risk. If a property manager buys a new one now, they risk being seen as "wasting" some portion of the item's value since they have replaced it when it still works. On the other hand, if management increases reserves rather than replace the boiler immediately, there is a risk that the boiler could fail at the least convenient time – for example, the coldest New Year's Eve on record – requiring rental of a portable boiler and other extra expenses associated with a time-critical system failure. Of course, there is also the possibility that the boiler could last longer than expected, providing the owner the financial windfall of extra service life along with the security of an adequate reserve account when replacement does become necessary.

Special Features for Section 202 Properties

Section 202 has been the federal government's primary production program for elderly multifamily housing for many years. Many of these properties are now aging in place, as are their residents. The properties are due for recapitalization, to undertake major capital improvements and reconfigurations, and to develop new services to meet changing resident needs. Responding to Section 202 sponsors, lenders, state housing agencies and others, Congress and HUD have adopted guidelines for prepayment and refinancing of existing Section 202 loans.[4] This represents a significant opportunity to relieve unfavorable debt burdens assumed twenty or more years ago (see Chapter 3).

One of the first Section 202 refinancings in the country, and possibly the first by a state agency, involved Peter Sanborn Place in Reading, MA (see transaction summary on page 15). Like many Section 202 properties, it is physically attractive, well-managed and financially viable. Over time, it had aged to a point where capital improvements were in order. Its residents

had aged as well; many now needed some modifications to their units and/or additional services in order to continue living independently.

A key element of the transaction at Peter Sanborn was a massive reduction in debt costs from the original mortgage loan at 9.25 percent. The Massachusetts Housing Finance Agency (MassHousing) was able to provide a new mortgage loan at 5.04 percent, freeing up $1.7 million for building improvements, resident services, and new replacement reserves. The recapitalization facilitated major kitchen and bath renovations for improved accessibility and functionality for a frail, elderly population. Other initiatives included common area lighting upgrades, a keyless entry system, 24-hour resident supervision, and an escrow to pay for other supportive services.

While most of the capital improvements were to be funded out of MassHousing financing proceeds, the CNA consultant had a significant role in helping establish a viable replacement reserve funding plan for the development's ongoing operation, and in determining how much of the existing reserves could be dedicated to the immediate rehab program. HUD has made third-party capital needs assessments an integral part of the rapidly-growing Section 202 refinancing program. On some of these, sponsors have been hard pressed to find significant capital improvements to undertake immediately. Instead, they have substantially recapitalized existing replacement reserves to meet needs further down the road which were documented by the CNA.

Sustainable Rehabilitation

The limited budgets associated with assessments of sustainable rehabilitation opportunities typically result in a focus on retrofits of property elements and systems. More effective CNAs will guide readers to consider alternative approaches to addressing a problem (e.g. converting to natural gas, or dual fuel technology when an oil-fired heating plant is to be replaced, or moving to more durable siding materials when the T1-11 siding goes). The idea here is to get the most "bang for the rehab buck," and make life better and easier for residents and management and maintenance staff.

In this vein, there is growing interest today in "high-performance" housing solutions to capital improvement needs, including energy efficient and green technologies. While a detailed exploration of such matters is beyond the scope of this handbook, substantial rehab programs offer an opportunity to strategically combine various improvements in a way that can achieve utility cost savings, reduce consumption and waste of building materials, and improve resident comfort and health. Combining solutions can offset undesired effects of a single solution. For instance, replacing leaky windows (an unintended source of fresh air in apartments) without attention to ventilation may simply swap one form of resident discomfort with another. Also, combining improvements in a manner that creates recognizable energy benefits can be used to leverage funds for other work. Many utility companies around the country now offer attractive conservation incentive programs. These often can be combined with special energy loans and foundation grant resources.

When developing a recapitalization program for an older facility, sponsors would often be well-advised to look at opportunities to tighten up their building envelope, such as adding insulation when replacing a roof. Another option for sponsors to consider is upgrading HVAC and domestic hot water generation systems. This might entail moving from one large heating boiler to two or more smaller boilers with comparable total capacity. Operating only as many boilers as are needed at any time reduces overall energy usage. It is also possible that with a tighter envelope, boilers and or AC chillers could be re-sized downward. Finally, the use of energy-efficient permanent lighting and appliances reduces a property's base energy load and may qualify for utility rebates.

In the area of high-performance housing solutions, considerable weight should still be given to well-established and proven technologies. A CDC should be properly skeptical of exotic new technology that may not provide promised results or that prove difficult to maintain (e.g. heating or cooling equipment made overseas, and those beyond the maintenance capacity of the local HVAC contractor).

Environmental Considerations

For an entity looking to acquire an existing facility, particularly one that is mature, a Phase I environmental assessment, separate from the capital needs assessment, will likely be in order. These typically include a review of historic records to identify potentially adverse previous uses of the property (for example presence of abandoned underground gasoline storage tanks), visual assessment of potential existing hazards (abandoned maintenance facilities and electrical transformers), and generally limited materials testing for radon, lead-based paint and asbestos.

Two of the better understood environmental hazards in older multifamily properties – lead-based paint and asbestos – are also significant potential legal liabilities, and enormous expenses if remediation is required.

While there isn't room here to cover these issues in depth, development sponsors and managers should be mindful of these in the course of recapitalizing properties built before the late 1970s, when both materials were phased out of wide-spread use.

Lead Based Paint (LBP)
Before 1977, lead was widely used to enhance the color and durability of paints. Many of the qualities that made it useful in paint and plaster products contribute to its health effects. It does not decompose and can't be excreted by the body; it builds up in blood and soft tissue instead. In adults, it can contribute to high blood pressure. It is a greater risk to children; its neuro-toxic effects include impaired IQ, shortened memory and attention span, and learning disabilities.

While lead-based paint has not been applied legally in residential structures for 25 years, it can still be found in older properties. A CDC looking to acquire an existing older property should seek and review the results of past testing from the current/past owner. If they are not available, the buyer should undertake testing; this must be done by licensed specialists. HUD has very specific standards for risk associated with LBP, and well-established guidelines for testing. There are two basic abatement options – encapsulation of sound, intact LBP materials with approved paint products, and removal. All LBP removal work must also be done by licensed contractors. It is intrusive and must be done under strict guidelines, including clean-up and post-abatement testing. This can be a very costly endeavor, fundamentally altering rehab plans and budgets.

Asbestos
Asbestos is a naturally occurring fibrous material that was used for years in fire-proofing and insulation materials. Damage or deterioration of asbestos-containing materials (ACMs) can result in the release into the air of microscopic fibers, which can then be inhaled. Asbestos has been linked to cancer and asbestosis (a chronic disease making breathing progressively more difficult). The hazards associated with ACMs have been known for some time, and asbestos has largely been removed from the marketplace. It can still be found in older properties, notably in boiler room plumbing insulation, vinyl flooring (both in tile and in the mastic used in installation), 'popcorn' ceiling finishes, and some siding and roofing materials. ACMs that are intact and in good condition do not pose a health hazard and need not be abated. ACM flooring can be encapsulated with carpet or vinyl material. However, where sound ACMs are identified, an 'operating and maintenance' or O & M plan should be developed to establish clear guidelines for handling this material going forward.

If demolition or rehab activity will disturb or damage such materials, this must be addressed very carefully, often at considerable expense. Remediation of these materials must be conducted carefully (wetted, containerized and labeled, and delivered to specially designated landfills). Cautious lenders may even forgo planned foreclosures on properties with widespread asbestos problems. Many old properties, with two layers of asphalt roof shingles, are now experiencing huge disposal costs associated with asbestos in the original materials.

Mold
An emerging environmental concern today is mold. Its health effects are less well understood, and unlike lead-based paint and asbestos there are no established standards for unacceptable conditions. Exposure to mold can have moderate to serious consequences for some persons, particularly those with respiratory conditions. Allergic reactions, asthma and fatigue are common outcomes.

Many types of mold exist. One closely linked to adverse health effects is *Stachybotrys chartarum*, a greenish black mold that grows on drywall, ceiling tiles and wood. (The black mold seen on bath tiles is not *Stachybotrys chartarum*.)

Mold can be found almost anywhere in the presence of moisture and oxygen; its growth can be controlled through attention to indoor moisture. Moisture problems can have various causes, including water infiltration from outside, plumbing deficiencies, and uncontrolled humidity (some energy-conscious design and construction practices in the past several decades have contributed to tightly-sealed and inadequately ventilated buildings).

There are a few questions to consider about mold risk in the context of a capital improvement program.

- Are there recognized moisture problems in the building?
- Are residents reporting musty or moldy odors?
- Are residents reporting health problems?
- Has maintenance been deferred?

Of course, property sponsors and managers should establish effective maintenance practices after rehabilitation, in order to reduce the chances of future

mold problems. Fix plumbing leaks and halt water infiltration. Enlist resident cooperation in reporting problems in their units. Keep HVAC drip pans clean and unobstructed. Prevent moisture build-up by increasing building ventilation and venting moisture-producing appliances outside.

The EPA has published a useful general resource on this issue, "Mold Remediation in Schools and Commercial Buildings." It includes a detailed discussion of appropriate remediation actions.

References

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The Visual Display of Quantitative Information. (Graphics Press) Copyright 1983 by Edward Tufte. The finest book ever on how to make, read, and analyze charts and graphs.

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Chapter 5 Notes

[1] Section 504 prohibits exclusion from or denial of federal government benefits because of a handicap. HUD has issued implementing regulations at 24 CFR 8 and 24 CFR 9.

[2] See *Stemming the Tide* at http://www.lisc.org/preservation.

[3] The *Fannie Mae Physical Needs Assessment Guidance to the Property Evaluator* is not in the public domain. The forms and expected useful life tables were developed for Fannie Mae by ON-SITE INSIGHT Inc. of Needham MA. Copyrights are shared between Fannie Mae and ON-SITE INSIGHT. Fannie Mae holds the rights to use the guidance and forms in its DUS and other lending programs and has licensed its use to HUD solely in connection with the implementation of the Multifamily Assisted Housing Reform and Accountability act of 1997. All other rights in use are the property of ON-SITE INSIGHT.

[4] HUD Notice 2002-16, "Prepayment of Direct Loans on Section 202 and 202/8 Projects with Inclusion of FHA Mortgage Insurance Guidelines" and Notice H 2004-21, "Amendments to Notice H 2002-16: Underwriting Guidelines for Refinancing of Section 202 and 202/8 Direct Loan Prepayments."

Private Letter Ruling
Number: 200703024
Internal Revenue Service
October 17, 2006

Internal Revenue Service
Department of the Treasury
Washington, DC 20224

Number: 200703024
Release Date: 1/19/2007
Index Number: 42.09-03, 42.08-06
Person To Contact:
ID No.
Telephone Number:
Refer Reply To:
CC:PSI:B05 – PLR-**130019-06**
Date: October 17, 2006

Dear ********* :

This letter responds to a letter dated June 7, 2006, made on behalf of Taxpayer, requesting rulings on proposed actions by Taxpayer that involve a right of first refusal under § 42(i)(7) of the Internal Revenue Code and a low-income housing commitment (commitment) under § 42(h)(6). The Internal Revenue Service Office that will have examination jurisdiction over Taxpayer is the Examination Office.

The relevant facts as represented by Taxpayer in these submissions are set forth below.

FACTS

Taxpayer is a State limited partnership, originally formed to acquire, rehabilitate develop, own and operate Project, located in City. The general partner of Taxpayer is General Partner. The limited partner of Taxpayer is Limited Partner.

Project is a multi-building, a-unit rental housing development, each unit of which is a low-income unit as defined under § 42(i)(3)(A) of the Code. Taxpayer acquired and rehabilitated Project in Year 1. In the same year, Project received an allocation of low-income housing credits pursuant to § 42 from Agency. The first year of Project's credit period was Year 1.

Project has a recorded a commitment (entitled "Declaration of Land Use Restriction Covenants for Low-Income Housing Tax Credits") dated as of b, as amended, for the 30-year period required by § 42(h)(6) of the Code, which commitment covers Project entirely. Agency can enforce the commitment.

Taxpayer wants to amend the commitment to provide the tenants of Project the opportunity to purchase their units upon the conclusion of the compliance period. All a units will remain as low-income rental units through the end of the compliance period. Taxpayer, with the support of Agency as described in a letter dated e, has developed an ownership plan (as described below) to accomplish this.

The ownership plan contemplates that all a units in Project will be converted to condominiums in accordance with the State Act and City ordinances. Upon the receipt of a favorable ruling from the Internal Revenue Service and prior to the end of Project's 15-year compliance period, Taxpayer will record (i) a declaration for the property stating Taxpayer's intent to convert all the units in Project to condominiums, and (ii) simultaneously with the recording of the declaration, a condominium plat. The condominium documents will

provide that the actual conversion to condominiums will not be effective until after the end of the compliance period.

Taxpayer and Agency have determined that a condominium conversion is the most beneficial structure to allow for tenant ownership.

Upon receipt of approval by Agency and Taxpayer's lenders and partners, the existing commitment will be amended to provide each tenant (and any successor occupant of that unit) a right of first refusal as provided under § 42(i)(7) of the Code to purchase their unit. Each tenant in good standing under their rental lease will be eligible to exercise such right.

Taxpayer represents that under the right of first refusal, the purchase price for each unit will be set so as to be affordable to the tenants because the purchase price will be based on the mortgage payments and condominium fees that could be paid by the tenant based on the maximum rents applicable to such unit at the time of sale. Taxpayer will also offer each tenant a discount on the purchase price of their unit, which discount will be tied to the compliance period of the building occupied by that tenant and based on the length of time that each tenant has lived in their unit during such period— 1% for each year a tenant has lived in their unit during the ten years preceding the year of condominium conversion. To receive the benefit of the discount, (i) the tenant must continue to reside in their unit at that time of the condominium conversion, and (ii) the tenant must exercise their right of first refusal to purchase the unit within 6 months from the date of the conversion.

Agency has determined that the prices to be used for sales of the condominium units will preserve their affordability. In all cases, the purchase price will not be less than the minimum purchase price described under § 42(i)(7) of the Code. Taxpayer intends to sell one-bedroom units for an estimated $c (subject to market conditions) and two-bedroom units for an estimated $d (subject to market conditions). Further, to maintain affordability for future buyers upon the resale of the condominium units, the resale price for each unit will not exceed the gross sales price paid by the seller (at the time the seller purchased the unit) plus a 10% per annum cumulative increase based on such gross sales price.

Subject to the receipt of a favorable ruling, Taxpayer will include in all new and renewed tenant leases notice that a condominium conversion may occur following the end of the compliance period. Further, when the time of the condominium conversion is known by Taxpayer, it will provide notice ("tenant notice") to all tenants describing when the condominium conversion process will begin after the end of each building's 15-year compliance period and the intent to sell the units, including the timing of the completion of the conversion process, the methods for selling the condominiums and sales prices of each, and information about the new commitment.

Each tenant will be allowed up to 6 months from the commencement of the conversion to exercise the right of first refusal. If a tenant does not exercise such right, the unit will continue as residential rental property, and the tenant will have the right to remain in the unit for as long as the tenant chooses. The rent for rental units will continue to be restricted to the maximum rents applicable to such units under § 42(g) of the Code.

Under the ownership plan, the existing commitment, as amended, will terminate after the close of the 15-year compliance period and upon the effective date of the condominium conversion, at which time a new commitment will be recorded against Project, in a manner consistent with Rev. Rul. 95-49, 1995-2 C.B. 7.

The period and affordability restrictions of the new commitment will be for 30 years, commencing on the date the new commitment is recorded, as described above. This commitment will be in a form substantially similar to a form of commitment already approved by Agency.

The new commitment will have two parts. The first part will address those units in which the tenant did not exercise their right of first refusal. Until such tenant vacates the unit, it will remain a rental unit subject to terms identical to the existing commitment. This will avoid displacement, as a tenant not electing to exercise

such right will not be evicted unless for good cause. When the tenant vacates their unit, Taxpayer may either continue the unit as a rental unit or offer it for sale to a qualified buyer. A qualified buyer is a person whose income at the time of purchase satisfies the applicable § 42 income limitation to which the Project is subject at the time. The second part of the new commitment will apply to all units sold as condominiums. It will require that each sale or sales must be to an existing tenant or qualified buyer. Eventually, when all rental units are sold, the provisions in the new commitment pertaining to the rental units will no longer apply and only the provisions relating to the condominium units sold will apply.

Agency's consent will be required to amend or terminate the new commitment. Further, Taxpayer will (i) keep Agency apprised of the implementation of the sales program during regular intervals preceding and following the start of the condominium conversion through its implementation, including providing Agency with 60-days advance notice prior to tenant notification of the condominium conversion process, the intent to sell the units, the timing of the completion of the conversion process, the methods for selling the condominiums and sales prices of each, and information about the new commitment. This will give Agency the opportunity to comment on the mechanism for reviewing the sales prices and overseeing that that condominiums are sold to qualified buyers; and (ii) obligate the condominium manager to monitor and annually report to Agency on the continued occupancy by, and sales to, qualified buyers (or tenants of the remaining rental units) whose incomes satisfied the applicable income limitation.

RULING REQUESTED

Taxpayer requests the Service to rule that:

(1) The right of first refusal granted by Taxpayer to each tenant as part of a condominium homeownership plan to purchase their unit after the close of the compliance period applicable to that unit will satisfy the requirements of § 42(i)(7)(A) of the Code, and

(2) Assuming Project's existing commitment otherwise satisfies § 42(h)(6) of the Code, it will continue to satisfy § 42(h)(6) even though it will (i) be amended to grant each tenant occupying their unit a right of first refusal to purchase that unit; (ii) terminate after the compliance period of the buildings in Project; and (iii) be replaced with a new commitment which will provide for (a) continuing § 42 rental income restrictions for all units which continue as rental units, and (b) § 42 income restrictions for all buyers (other than the existing tenants) of the units sold at the time they are sold.

LAW AND ANALYSIS:

Section 38(a) of the Code provides for a general business credit against tax that includes the amount of the current year business credit. Section 38(b)(5) provides that the amount of the current year business credit includes the low-income housing credit determined under ' 42(a).

Section 42(a) of the Code provides that, for purposes of § 38, the amount of the low-income housing credit determined under ' 42 for any taxable year in a 10-year credit period shall be an amount equal to the applicable percentage of the qualified basis of each qualified low-income building.

Section 42(h)(6)(A) of the Code provides that no tax credit is allowed for a building unless an extended low-income housing commitment (as defined in § 42(h)(6)(B)) between the low-income building owner and the appropriate housing credit agency is in effect at the end of the taxable year. The commitment is binding on all successors to the owner and includes certain provisions that continue after the close of the building's 15-year compliance period. The commitment provision under § 42(h)(6)(B)(i) ensures that a certain percentage of a low-income building's units will continue to be available for rental by low-income tenants after the close of the compliance period. The commitment provision under § 42(h)(6)(B)(iii) prohibits the disposition to any person of any portion of the building to which such agreement applies unless all of the building to which such agreement applies is disposed of to such person.

Section 42(i)(7) of the Code provides that no Federal income tax benefit shall fail to be allowable to a taxpayer with respect to any qualified low-income building merely by reason of a right of first refusal held by the tenants (in cooperative form or otherwise) to purchase the property after the close of the compliance period for a price which is not less than the minimum purchase price determined under § 42(i)(7)(B). Section 42(i)(7)(B) defines the minimum purchase price as an amount equal to the sum of (i) the principal amount of outstanding indebtedness secured by the building (other than indebtedness incurred with the 5-year period ending on the date of the sale to the tenants), and (ii) all Federal, State, and local taxes attributable to such sale. Except in the case of Federal income taxes, there shall not be taken into account under clause (ii) any additional tax attributable to the application of clause (ii).

Section 42(m)(1)(B) of the Code provides that the term "qualified allocation plan" means any plan (i) that sets forth selection criteria to be used to determine housing priorities of the housing credit agency which are appropriate to local conditions, (ii) which also gives preference in allocating housing credit dollar amounts among selected projects to (I) projects serving the lowest income tenants, (II) projects obligated to serve qualified tenants for the longest periods, and (III) projects which are located in qualified census tracts (as defined in § 42(d)(5)(C)) and the development of which contributes to a concerted community revitalization plan, and (iii) which provides a procedure that the agency (or an agent or other private contractor of such agency) will follow in monitoring for noncompliance with the provisions of this section and in notifying the Service of such noncompliance which such agency becomes aware of and in monitoring for noncompliance with habitability standards through regular site visits.

Section 42(m)(1)(C) of the Code provides that certain selection criteria must be used by the housing credit agency in the qualified allocation plan. The selection criteria set forth in a qualified allocation plan must include (i) project location, (ii) housing needs characteristics, (iii) project characteristics, including whether the project includes the use of existing housing as part of a community revitalization plan, (iv) sponsor characteristics, (v) tenant populations with special housing needs, (v) public housing waiting lists, (vii) tenant populations of individuals with children, and (viii) projects intended for eventual tenant ownership.

Rev. Rul. 95-49, 1995-2 C.B. 7, concludes that an extended low-income housing commitment satisfies § 42(h)(6) of the Code even though its provisions may be suspended or terminated after the compliance period when a tenant exercises a right of first refusal to purchase a low-income building.

Notice 88-91, 1988 C.B. 414, concludes that final regulations will provide that the term "qualified low-income building' includes residential rental property that is an apartment building, a single family dwelling, a townhouse, a row house or duplex, or a condominium.

As provided in Rev. Rul. 95-49, the objectives of § 42(h)(6) and § 42(i)(7) of the Code are similar in that both sections attempt to promote housing for low-income individuals beyond the compliance period, by rental in the case of § 42(h)(6) or by outright ownership in the case of § 42(i)(7). Section 42(i)(7) provides that the right of first refusal may be held by the tenants in cooperative form *or otherwise* (emphasis added). Thus, implicitly, § 42(i)(7) can permit a right of first refusal to be held by tenants in their individual capacity. In the case of a multi-unit building, where a tenant only has an interest in purchasing their own living unit, conversion of the units into separate condominiums is a practical form for accomplishing the sale of such units.

Further, Rev. Rul. 95-49 provides latitude to owners and state allocating agencies in achieving the objectives of ownership for qualifying individuals in that the provisions of a § 42(h)(6) commitment may be terminated or suspended following the close of the compliance period upon the exercise of a right of first refusal. Thus, § 42(h)(6)(B)(iii), which prohibits the disposition to any person of any portion of the building to which an agreement applies unless all of the building to which such agreement applies is disposed of to such person, may, as under Taxpayer's facts, be made inapplicable if agreed to by the owner and agency. Similarly, § 42(h)(6)(B)(i), which ensures that a certain percentage of a low-income building's units will continue to be available for rental by low-income tenants after the close of the compliance period, may also be terminated or suspended if agreed to by the owner and agency.

Taxpayer represents that in all cases, the purchase price of the condominium units will not be less than the minimum purchase price as described under § 42(i)(7) of the Code. Taxpayer further represents that the condominium conversion process and sale of the units will not begin until after the close of the compliance period for Project buildings.

Agency has indicated that it supports the proposed ownership plan as described in the above facts.

Accordingly, based solely on the Taxpayer representations of fact and relevant law as set forth above, we conclude that:

(1) The right of first refusal granted by Taxpayer to each tenant as part of a condominium homeownership plan to purchase their unit after the close of the compliance period applicable to that unit satisfies the requirements of § 42(i)(7)(A) of the Code, and

(2) Assuming Project's existing commitment otherwise satisfies § 42(h)(6) of the Code, the commitment will continue to satisfy § 42(h)(6) even though it will (i) be amended to grant each tenant occupying their unit a right of first refusal to purchase that unit; (ii) terminate after the compliance period of the buildings in Project; and (iii) be replaced with a new commitment that will provide for (a) continuing § 42 rental income restrictions for all units which continue as rental units, and (b) § 42 income restrictions for all buyers (other than the existing tenants) of the units sold.

We express no opinion on any other aspect of ' 42 of the Code, including whether Project's existing commitment presently satisfies § 42(h)(6). This ruling does not in anyway obligate Agency to amend their existing commitment or otherwise agree to any of the contemplated changes described in Taxpayer's request.

In accordance with the power of attorney, we are sending a copy of this letter ruling to Taxpayer's authorized representatives.

This ruling is directed only to Taxpayer. Section 6110(k)(3) provides that it may not be used or cited as precedent. A copy of this letter should be retained by Taxpayer for its records.

Sincerely yours,

/s/ SUSAN REAMAN

Susan Reaman Chief, Branch 5
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure:

[Federal Register: June 19, 2007 (Volume 72, Number 117)]
[Proposed Rules]
[Page 33706-33711]
From the Federal Register Online via GPO Access [wais.access.gpo.gov]
[DOCID:fr19jn07-27]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-114084-04]
RIN 1545-BD20

Section 42 Qualified Contract Provisions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: Section 42(h)(6)(F) requires the Secretary to prescribe such regulations as may be necessary or appropriate to carry out the provisions of section 42(h)(6)(F), including regulations to prevent the
manipulation of the qualified contract amount. This document contains proposed regulations that provide guidance concerning taxpayers' requests to housing credit agencies to obtain a qualified contract (as defined in section 42(h)(6)(F) of the Internal Revenue Code) for the acquisition of a low-income housing credit building. The regulations will affect taxpayers requesting a qualified contract, potential buyers, and low-income housing credit agencies responsible for the administration of the low-income housing credit program. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by September 17,

2007. Outlines of topics to be discussed at the public hearing scheduled for October 15, 2007, must be received by September 13, 2007.

ADDRESSES: Send submissions to: Internal Revenue Service, CC:PA:LPD:PR (REG-114084-04), room 5203, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-114084-04), Courier's Desk, Internal Revenue Service, 1111 Constitution
Avenue, NW., Washington, DC, or may be sent electronically via the Federal eRulemaking Portal at: http://frwebgate.access.gpo.gov/cgi-bin/leaving.cgi?from=leavingFR.html&log=linklog&to=http://www.regulations.gov (IRS REG-

114084-04). The public hearing will be held in the auditorium, Internal
Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Jack Malgeri (202) 622-3040; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Kelly Banks, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed
rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collections of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the
Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by August 20, 2007.

Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the
proper performance of the functions of the Internal Revenue Service,

including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collections of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The collection of information in this proposed regulation is in Sec. 1.42-18(a)(1)(ii)(B). This information is required in order for a taxpayer to provide a written request to a housing credit agency to obtain a qualified contract (as defined in section 42(h)(6)(F) of the Internal Revenue Code) for the acquisition of a low-income housing credit building. The collection of information is voluntary to obtain a benefit. The likely respondents are business or other for-profit institutions.

Estimated total annual reporting burden: 20,000 hours.

Estimated average annual burden hours per respondent: 1 hour.

Estimated number of respondents: 20,000.

Estimated annual frequency of responses: One time.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

This document contains amendments to 26 CFR part 1 under section 42 of the Internal Revenue Code (Code). Section 42 was amended by section 7108(c)(1) of the Omnibus Budget Reconciliation Act

[[Page 33707]]

of 1989 (Pub. L. 101-239, 103 Stat. 2106) to add paragraph (h)(6). In

general, section 42(h)(6)(A) provides that no credit will be allowed 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 the taxable year.

Section 42(h)(6)(B) provides in part that the term commitment means any agreement between the taxpayer and the low-income housing credit agency (Agency) that requires that the applicable fraction (as defined in section 42(c)(1)) for the building for each taxable year in the extended use period will not be less than the applicable fraction specified in the commitment, and that prohibits the eviction or termination of tenancy (other than for good cause) of an existing tenant of any low-income unit and any increase in the gross rent with respect to the unit not otherwise permitted under section 42.

Section 42(h)(6)(D) defines the term extended use period as the period beginning on the first day in the compliance period under section 42(i)(1) on which the building is part of a qualified low-income housing project and ending on the later of: (1) The date specified by the Agency in the commitment, or (2) the date which is 15 years after the close of the compliance period.

Section 42(h)(6)(E)(i)(II) provides for the termination of the extended use period if the Agency is unable to present within a specified period of time a qualified contract for the acquisition of the low-income portion of the building by any person who will continue to operate such portion as a low-income building.

Section 42(h)(6)(F) defines the term qualified contract as a bona fide contract to acquire (within a reasonable period of time after the contract is entered into) the non low-income portion of the building for fair market value and the low-income portion of the building for an amount not less than the applicable fraction (specified in the commitment) of the sum of: (I) The outstanding indebtedness secured by, or with respect to the building, (II) the adjusted investor equity in the building, plus (III) other capital contributions not reflected in these amounts, reduced by cash distributions from (or available for distribution from) the project.

Section 42(h)(6)(F) also provides that the Secretary shall prescribe regulations as may be necessary or appropriate to carry out that paragraph, including regulations to prevent the manipulation of the amount determined under section 42(h)(6)(F).

Section 42(h)(6)(I) provides that the Agency must present the qualified contract within the 1-year period beginning on the date

(after the 14th year of the compliance period) the taxpayer submits a written request to the Agency to find a person to acquire the taxpayer's interest in the low-income portion of the building.

These proposed regulations provide guidance with respect to the application of the qualified contract provisions of section 42.

Explanation of Provisions

Qualified Contract Formula

Section 1.42-18(c)(1) of the proposed regulations defines the qualified contract formula used to compute the purchase price amount of the low-income housing building as: (1) The fair market value of the non low-income portion of the building, plus (2) the low-income portion of the building. Section 1.42-18(c)(2) of the proposed regulations defines the low-income portion of the building as an amount not less than the applicable fraction (as specified in the commitment) of the total of: (a) Outstanding indebtedness on the building, plus (b) the adjusted investor equity in the building, plus (c) other capital contributions not reflected in the amounts in described in (a) and (b), minus (d) cash distributions from (or available for distribution from) the project.

Under Sec. 1.42-18(b)(3) of the proposed regulations, the fair market value of the non low-income portion of the building is its fair market value at the time of the Agency's offer of sale. Because the intent of the extended-long term commitment is the continued use of the low-income portion of the building as low-income housing, the Treasury Department and IRS believe that fair market value must reflect the restrictions on the use of the low-income portion of the building. Therefore, the proposed regulations provide that the valuation must take into account the existing and continuing requirements under the commitment for the building.

Section 42(h)(6) does not discuss the appropriate treatment of land in the calculation of qualified contracts. Qualified contracts are defined by reference to the building, which for other purposes of section 42 generally does not include the underlying land. However, because the Treasury Department and the IRS anticipate that the sales of the building without the underlying land would be infrequent, the

Treasury Department and the IRS believe that it is necessary to include the underlying land in the computation of the qualified contract formula. Therefore, the proposed regulations provide that the non low-income portion also includes the fair market value of the land underlying the entire building, both the non low-income portion and the low-income portion, regardless of whether the building is entirely low-income. Comments are requested on whether low-income buildings are ever sold without the underlying land, and if so, the appropriate treatment in those cases. In addition, comments are requested on the appropriate treatment of leased land and the prevalence of leased land in low-income housing credit transactions.

For purposes of determining the low-income portion of the building, Sec. 1.42-18(c)(3) defines the term outstanding indebtedness as the outstanding principal balance, at the time of the sale, of any indebtedness or loan that is secured by, or with respect to, the building, and that does not exceed the amount of qualifying building costs. Qualifying building costs are generally defined in Sec. 1.42-18(b)(4) of the proposed regulations as those costs that would have been includible in eligible basis of a low-income housing building under section 42(d)(1), provided the amounts were expended for depreciable property that conveys under the contract with the building. Thus, for example, the outstanding mortgage on the building will generally be outstanding indebtedness for purposes of section 42(h)(6)(F), even if the indebtedness is incurred after the first year of the credit period, but only up to the amount of costs included in original eligible basis established at the end of the first year of the credit period under section 42(f)(1), plus indebtedness for qualifying building costs incurred after the first year of the credit period of a type that could be includible in eligible basis under section 42(d)(1). Thus, any proceeds from refinancing indebtedness or additional mortgages in excess of such qualifying building costs are not outstanding indebtedness for purposes of section 42(h)(6)(F).

Outstanding indebtedness with an interest rate below the applicable Federal rate (as determined under section 1274(d)) at the time of issuance must be discounted using a present-value calculation to

obtain
an imputed principal amount. This imputed principal amount constitutes the amount of indebtedness that must be utilized in calculating the amount of outstanding indebtedness under the qualified contract formula.

[[Page 33708]]

Section 1.42-18(c)(4) of the proposed regulations provides that adjusted investor equity includes only those cash investments by owners
of the low-income building used for qualifying building costs. Investor
equity is adjusted by a cost of living adjustment not to exceed five percent. The cost-of-living adjustment is determined under section 1(f)(3), substituting the language in section 1(f)(3)(B) with ``the CPI
for the base calendar year.'' The base calendar year is the calendar year with or within which the first taxable year of the credit period ends. Thus, the cost-of-living adjustment is the percent by which the Consumer Price Index (CPI) for the year preceding the written request to find a person to acquire the project exceeds the CPI for the base calendar year.

Under Sec. 1.42-18(c)(5) of the proposed regulations, other capital contributions are defined as contributions for qualifying building costs other than amounts included in the calculation of outstanding indebtedness or adjusted investor equity as defined in this
section. An example of other capital contributions includes an amount expended to replace a furnace after the first year of the credit period, provided any loan taken to finance the furnace was not secured by the furnace or the building. In this example, the loan would be outstanding indebtedness on the building.

Qualifying building costs are defined under Sec. 1.42-18(b)(4)(i) and (ii) of the proposed regulations. Under Sec. 1.42-18(b)(4)(i) of the proposed regulations, a qualifying building is a cost included in eligible basis under section 42(d)(1). A cost is included in eligible basis under section 42(d)(1) only if the cost is (1) included in the adjusted basis of depreciable property subject to section 168 and the property qualifies as residential rental property under section 142(d) and Sec. 1.103-8(b)(4)(iii), or (2) included in the adjusted basis of depreciable property subject to section 168 that is used in a common area or provided as a comparable amenity to all residential rental

units in the building, but only if the property conveys under the contract with the building. A qualifying building cost also includes costs incurred after the first year of the credit period (as defined in section 42(f)) of the type included in eligible basis under section 42(d)(1). See Sec. 1.42-18(b)(4)(ii) of the proposed regulations.

Under the qualified contract formula, the sum of the outstanding indebtedness, adjusted investor equity, and other capital contributions is reduced by cash distributions from or available for distribution from the project. Section 1.42-18(c)(6) of the proposed regulations defines cash distributions as including all distributions to owners or related parties within the meaning of section 267(b) or 707(b) (for example, cash distributions to owners from the proceeds of refinancings and second mortgages in excess of existing mortgages), and all cash and cash equivalents including reserve funds (for example, replacement and operating reserves) generated by cash flow from the project. To the extent an owner contributed his or her own funds to a reserve fund for replacement and improvements, such amounts are evaluated as either adjusted investor equity or other capital contributions. The Treasury Department and the IRS request comments and examples of forms of cash distributions from or available for distribution from the project that should or should not be included in the regulatory definition. Additionally, comments are requested whether low-income housing is owned by other than a corporation or partnership, for example, a sole proprietor, estate, or trust, and if so, what rules should apply for determining the amount of cash distributions from the project.

Administrative Discretion and Responsibilities of Agency

Under Sec. 1.42-18(d)(1) of the proposed regulations, the Agency may exercise administrative discretion in evaluating and acting upon an owner's request to find a buyer to acquire the building. For example, the Agency may determine that an owner's request to find a buyer for the project lacks essential information and it may suspend the one-year period for finding a buyer until essential information is submitted.

Actual Offer of Sale

Section 1.42-18(d)(2) of the proposed regulations provides that in order to satisfy the qualified contract requirements under section 42(h)(6), the Agency must offer the building for sale to the general public at the determined qualified contract price upon receipt of a written request by the owner to find a buyer to acquire the building.

Fair Market Value Cap

Commentators suggested the inclusion of a fair market value cap on the low-income portion of the qualified contract amount as defined in section 42(h)(6)(F) noting that the qualified contract price may exceed the fair market value of a project. Commentators noted one reason for the qualified contract price exceeding fair market value is the formula for adjusted investor equity, which includes the CPI-based cost of living adjustments. The statute defines a qualified contract, in part, as a contract to acquire the low-income portion of the building for an amount ``not less than'' the applicable fraction of the statutorily provided formula. Therefore, the proposed regulations do not adopt this comment. However, the flush language of section 42(h)(6)(E) provides that the qualified contract exception to the termination of the extended use period of a commitment shall not apply to the extent more stringent requirements are provided in the commitment or in state law. The Treasury Department and the IRS request comments on the extent of Agency and state authority in providing more stringent requirements than the provisions contained in section 42(h)(6)(F), and specifically, the authority of Agency or state regulators to require in agreements a fair market value cap that would restrict any qualified contract price to fair market value.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of

small
entities. This certification is based on the fact that the collection of information described under the heading ``Paperwork Reduction Act'' imposes virtually no incremental burden in time or expense and is voluntary for the taxpayer to obtain a benefit. Therefore, a regulatory
flexibility analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal
Revenue Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations,
consideration will be given to any written (a signed original and eight
(8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of
the proposed

[[Page 33709]]

rules and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for October 15, 2007, beginning
at 10 a.m. in the auditorium of the Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the FOR FURTHER INFORMATION CONTACT section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who
wish to present oral comments at the hearing must submit electronic or

written comments on September 17, 2007 and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by September 13, 2007. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these proposed regulations is Jack Malgeri,
Office of Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding
an entry in numerical order as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.42-18 also issued under 26 U.S.C. 42(h)(6)(F) and 42(h)(6)(K); * * *
Par. 2. Section 1.42-18 is added to read as follows:

Sec. 1.42-18 Qualified contracts.

(a) Extended low-income housing commitment--(1) In general. No credit under section 42(a) is allowed by reason of section 42 and this section 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 under paragraph (a)(1)(i) of this section for any building will terminate--

(A) On the date the building is acquired by foreclosure (or instrument in lieu of foreclosure) unless the Secretary determines that such acquisition is part of an arrangement with the taxpayer 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) the owner submits a written request to the Agency to find a person to acquire the owner's interest in the low-income portion of the building and the Agency is unable to present during such period a qualified contract for the acquisition of the low-income portion of the building by any person who will continue to operate such portion as a qualified low-income building (as defined in section 42(c)(2)). This paragraph (a)(1)(ii)(B) shall not apply to the extent more stringent requirements are provided in the commitment or under state law. 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.

(iii) Eviction, gross-rent increase concerning existing low-income tenants not permitted. During the three-year period following the termination of a commitment, no owner shall be permitted to evict or terminate the tenancy (other than for good cause) of an existing tenant of any low-income unit, or increase the gross rent for such unit in a

manner or amount not otherwise permitted by section 42.

(2) [Reserved]

(b) Special rules. For purposes of this section, the following terms are defined:

(1) Base calendar year means the calendar year with or within which the first taxable year of the credit period ends.

(2) The low-income portion of a building is the portion of the building equal to the applicable fraction (as defined in section 42(c)(1)) specified in the commitment for the building.

(3) The fair market value of the non low-income portion of the building is determined at the time of the Agency's offer of sale of the project to the general public. This valuation must take into account the existing and continuing requirements contained in the commitment for the building. The non low-income portion also includes the fair market value of the land underlying the entire building, both the non low-income portion and the low-income portion regardless of whether the project is entirely low-income. The non low-income portion also includes the fair market value of items of personal property not included in eligible basis under section 42(d)(1) that convey under the contract with the building.

(4) A qualifying building cost is--

(i) A cost that is included in eligible basis of a low-income housing building under section 42(d)(1) which is--

(A) Included in the adjusted basis of depreciable property subject to section 168 and the property qualifies as residential rental property under section 142(d) and Sec. 1.103-8(b)(4)(iii); or

(B) Included in the adjusted basis of depreciable property subject to section 168 that is used in a common area or provided as a comparable amenity to all residential rental units in the building; and

(ii) Of the type described in paragraph (b)(4)(i) of this section incurred after the first year of the low-income building's credit period under section 42(f).

(c) Qualified contract purchase price formula--(1) In general. For purposes of this section, the term qualified contract means a bona fide contract to acquire (within a reasonable period after the contract is entered into) the non low-income portion of the building for fair market value (as defined in paragraph (b)(3) of this section) and the low-income portion of the building (as defined in paragraph (b)(2) of

this section) for the low-income portion amount as calculated in paragraph (c)(2) of this section. The qualified contract amount is determined at the time of the Agency's offer of sale of the project to the general public. An Agency must,

[[Page 33710]]

however, adjust the amount of the low-income portion of the qualified contract formula to reflect changes in the components of the qualified contract formula such as mortgage payments which reduce outstanding indebtedness between the time of the seller's request to the Agency to obtain a buyer and the project's actual sale closing date. In addition,
the Agency may adjust the fair market value of the building if, after a
reasonable period of time within the one-year offer of sale period, no buyer has made an offer or market values have adjusted downward.

(2) Low-income portion amount. The low-income portion amount is an amount not less than the applicable fraction specified in the commitment, as defined in section 42(h)(6)(B)(i), multiplied by the total of--

(i) The outstanding indebtedness for the building (as defined in paragraph (c)(3) of this section); plus

(ii) The adjusted investor equity in the building (as defined in paragraph (c)(4) of this section); plus

(iii) Other capital contributions (as defined in paragraph (c)(5) of this section), not including any amounts described in paragraphs (c)(2)(i) and (ii) of this section; minus

(iv) Cash distributions from (or available for distribution from) the building (as defined in paragraph (c)(6) of this section).

(3) Outstanding indebtedness. (i) For purposes of paragraph (c)(2)(i) of this section, except as provided in paragraph (c)(3)(ii) of this section, the term outstanding indebtedness for the building means the remaining stated principal balance, at the time of the Agency's offer of sale of the project to the general public, of any indebtedness secured by, or with respect to, the building that does not
exceed the amount of qualifying building costs described in paragraph (b)(4) of this section. Examples of such indebtedness include certain mortgages and developer fee notes (excluding developer service costs not included in eligible basis). Outstanding indebtedness does not include debt used to finance nondepreciable land costs, syndication costs, legal and accounting costs, and operating deficit payments. The

term outstanding indebtedness for the building only includes obligations that are indebtedness under general principles of Federal income tax law.

(ii) For purposes of paragraph (c)(2)(i) of this section, if the indebtedness had a yield to maturity below the applicable Federal rate (as determined under section 1274(d)) at the time of issuance, the term outstanding indebtedness for the building is the imputed principal amount of the indebtedness, secured by, or with respect to, the building, at the time of the Agency's offer of sale of the project to the general public, that does not exceed the amount of qualifying building costs described in paragraph (b)(4) of this section. The imputed principal amount of the indebtedness is the sum of the present values, as of the Agency's offer of sale of the project to the general public, of all the remaining payments of principal and interest payable on the indebtedness after the Agency's offer of sale of the project to the general public. The present value of each payment is determined by using a discount rate equal to the applicable Federal rate (as determined under section 1274(d)) at the time of issuance of the indebtedness. In the case of a variable rate debt instrument, rules similar to those in Sec. 1.1274-2(f) are used to determine the instrument's imputed principal amount.

(4) Adjusted investor equity. (i) For purposes of paragraph (c)(2)(ii) of this section, the term adjusted investor equity for any calendar year means the aggregate amount of cash invested by owners for qualifying building costs described in paragraph (b)(4)(i) of this section. Thus, equity paid for land, credit adjuster payments, Agency low-income housing credit application and allocation fees, operating deficit contributions, and legal, syndication, and accounting costs all are examples of cost payments that do not qualify as adjusted investor equity under this section.

(ii) The adjusted investor equity as determined under paragraph (c)(4)(i) of this section is increased by an amount equal to the adjusted investor equity multiplied by the cost-of-living adjustment for such calendar year, determined under section 1(f)(3) by substituting for the language in section 1(f)(3)(B), the Consumer Price Index for all urban consumers (CPI) (not seasonally adjusted, U.S. City Average) as specified in paragraph (c)(4)(v) of this section for the

base calendar year (as defined in paragraph (b)(1) of this section).

(iii) Adjusted investor equity is taken into account under this section only to the extent there existed an obligation to invest the amount as of the beginning of the low-income building's credit period (as defined in section 42(f)(1)).

(iv) Adjusted investor equity does not include amounts included in the calculation of outstanding indebtedness as defined in paragraph (c)(3) of this section.

(v) The cost-of-living adjustment is based on the CPI as of the close of the 12-month period ending on August 31 of the calendar year. The cost-of-living adjustment is the percent by which the CPI for the year preceding the written request to find a person to acquire the taxpayer's project (CPIp) exceeds the CPI for the base calendar year (CPIb). If the CPI for any calendar year during this period (after the base calendar year) exceeds the CPI for the preceding calendar year by more than 5 percent, the CPI for the base calendar year shall be increased such that such excess shall never be taken into account under paragraph (c)(4) of this section. The adjusted investor equity equals the aggregate amount of cash invested by the taxpayer in the building multiplied by the ratio of CPIp to CPIb.

(vi) Example. The following example illustrates the CPI calculation:

Example. Owner contributed $600,000 in equity to a building in 1991, which was the first year of the credit period for the project. In year 2005, owner requests Agency to find a buyer to purchase the building. The CPIb (at the close of the 12-month period ending on August 31, 1991) is 136.6. The CPIp for the close of the 12-month period ending August 31, 2004, is 189.5. At no time during this period (after the base calendar year) did the CPI for any calendar year exceed the CPI for the preceding calendar year by more than 5 percent. The owner's adjusted investor equity is $600,000 multiplied by 189.5/136.6, or $832,357.

(5) Other capital contributions. For purposes of paragraph (c)(2)(iii) of this section, other capital contributions to a low-income building are qualifying building costs described in paragraph (b)(4)(ii) of this section paid or incurred by the owner of the low-income building other than amounts included in the calculation of outstanding indebtedness or adjusted investor equity as defined in this

section. For example, other capital contributions may include amounts incurred to replace a furnace after the first year of a low-income housing credit building's credit period under section 42(f), provided any loan used to finance the replacement of the furnace is not secured by the furnace or the building. Other capital contributions do not include expenditures for land costs, operating deficit payments, credit adjuster payments, and payments for legal, syndication, and accounting costs.

(6) Cash distribution--(i) In general. For purposes of paragraph (c)(2)(iv) of this section, the term cash distributions from (or available for distribution from) the project include--

(A) All distributions from the project to the owners or to related parties within the meaning of section 267(b) or section 707(b)), including distributions under section 301 (relating to distributions by a corporation), section

[[Page 33711]]

731 (relating to distributions by a partnership), or section 1368 (relating to distributions by a S corporation); and

(B) All cash and cash equivalents available for distribution at the time of sale, including for example, reserve funds whether operating or replacement reserves.

(ii) Anti-abuse rule. The Commissioner will interpret and apply the rules in this paragraph (c)(6) as necessary and appropriate to prevent manipulation of the qualified contract amount. For example, cash distributions include payments to owners or related parties within the meaning of section 267(b) or section 707(b) for any operating expenses in excess of amounts reasonable under the circumstances.

(d) Administrative responsibilities of the Agency--(1) In general. An Agency may exercise administrative discretion in evaluating and acting upon an owner's request to find a buyer to acquire the building. Examples of administrative discretion may include but are not limited to the following:

(i) Concluding that the owner's request lacks essential information and denying the request until such information is provided.

(ii) Refusing to consider an owner's representations without substantiating documentation verified with the Agency's records.

(iii) Suspending the one-year period for finding a buyer until the owner provides requested information.

(iv) Determining how many subsequent requests to find a buyer, if any, may be submitted if the owner has previously submitted a request for a qualified contract and then rejects or fails to act upon the qualified contract furnished by the Agency.

(v) Assessing and charging the seller certain administrative fees for the performance of services in obtaining a qualified contract (for example, real estate appraiser costs).

(vi) Requiring other conditions applicable to the qualified contract consistent with this section.

(2) Actual offer. Upon receipt of a written request from the owner to find a person to acquire the building, the Agency must offer the building for sale at the determined qualified contract amount to the general public in order for the qualified contract to satisfy the requirements of this section unless the Agency has already identified a willing buyer who submitted a contract to purchase the building.

(e) Effective/applicability date. This section is applicable on the date the final regulations are published in the Federal Register.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

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September 17, 2007

Internal Revenue Service
CC:PA:LPD:PR (REG-114084-04)
Room 5203
PO Box 7604
Ben Franklin Station
Washington, DC 20044

RE: Comments on Proposed Regulations Implementing Section 42 Qualified Contract Provisions

Ladies and Gentlemen:

The Affordable Housing Tax Credit Coalition (the "Coalition") is submitting these comments in response to the above-cited notice of proposed rulemaking. The Coalition is a national trade association based in Washington, DC comprised of syndicators, investors, developers, lenders, housing credit agencies and professionals who are deeply involved in the low-income housing tax credit ("Housing Credit") industry. Our members are responsible for raising a substantial portion of the equity capital that is invested in properties which generate Housing Credits. We have a great deal of experience with respect to the financing, development and tax matters pertaining to the Housing Credit program. We appreciate your consideration of these comments.

BACKGROUND

In 1989, the Congress enacted Section 42(h)(6) of the Code. In doing so, Congress reflected a concern that the properties developed using the Housing Credit be preserved for low-income use for an extended period, generally at least thirty years. However, the Congress also recognized a concern expressed by owners, syndicators and investors, including Coalition members, that extending the low-income use period to thirty years could discourage or decrease capital investment in these properties; if investors had no opportunity to recoup their investment or benefit from the potential appreciation of the property's value as an unrestricted property for at least thirty years, then investors' would likely to be less willing to provide capital or as much capital.

Accordingly, the enactment of Section 42(h)(6) reflected a compromise recognizing the need to preserve Housing Credit properties

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for an extended period but providing a mechanism by which owners and investors could, if they chose to do so, either receive a fair return on their investment, determined by receipt of a "qualified contract" or be permitted to end the low-income use restrictions on the property (after a phase-out period). The ability to utilize a qualified contract makes it feasible to develop properties in areas where land costs are high, since it provides developers and investors with the ability to recognize a return on their investment. The mechanism to be employed permits the owner to request anytime after the fourteenth year of the compliance period that the housing credit agency present a "qualified contract" for the acquisition of the low-income portion of the building by any person who will continue to operate such portion as a qualified low-income building[1]. The housing credit agency is given a one-year period after the owner's written request to find a buyer. In the event that no qualified contract is presented, then the extended use period terminates, subject to a three year period during which existing tenants may not be evicted, except for good cause, and rents may not be raised except in conformity with Section 42.

A "qualified contract" is defined in Section 42(h)(6)(F) as a "bona fide contract to acquire (within a reasonable period after the contract is entered into) the non-low-income portion of the building for fair market value and the low-income portion of the building for an amount not less than the applicable fraction (specified in the extended low-income housing commitment) of—

(i) the sum of—

(I) the outstanding indebtedness secured by, or with respect to, the building,
(II) the adjusted investor equity in the building, plus
(III) other capital contributions not reflected in the amounts described in subclause (I) or (II), reduced by

(ii) cash distributions from (or available for distribution from the project.)"

[1] We note that there is an inconsistency in the statutory language. Under Section 42(h)(6)(B)(iii), there is a prohibition on disposing of a building unless the entire building is disposed of to one person. Accordingly, we believe that the Congress intended the qualified contract process to relate to both the low-income and nonlow-income portion of a building despite the language in Section 42(h)(6)(E)(i)(II) that refers only to the low-income portion.

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The "adjusted investor equity" is defined in sub-clause (G) as the "aggregate amount of cash taxpayers invested with respect to the project increased by the amount equal to—

(I) such amount, multiplied by
(II) the cost-of-living adjustment for such calendar year, determined under Section 1(f)(3) by substituting the base calendar year for 'calendar year 1987'.

An amount shall be taken into account as an investment in the project only to the extent there was an obligation to invest such amount as of the beginning of the credit period and to the extent such amount is reflected in the adjusted basis of the project."

Our comments are organized as follows: Section I deals with questions as to which the Service has specifically asked for comment in the Preamble to the Proposed Regulations. Section II deals with concerns with specific provisions set forth in the Proposed Regulations. Section III deals with areas which the Coalition believes should be, but are not addressed, in the Proposed Regulations.

SECTION I—RESPONSES TO QUESTIONS RAISED BY THE SERVICE

1) Are buildings ever sold without the underlying land, and if so, what is the appropriate treatment?

Response: Our experience is that while most buildings are constructed on land owned in fee simple by the owner, a substantial number of buildings are constructed on land subject to a long term ground lease. This is particularly true in buildings owned by public housing authorities and financed under the Department of Housing and Urban Development's mixed finance programs, including the HOPE VI program. However, in such cases, in order to demonstrate ownership of the buildings in the land lessee for federal income tax purposes, the ground lease has a very long term, generally in excess of 65 years and often as long as 99 years. Accordingly, buildings that are subject to a long term ground lease will continue to be held by the purchaser for a period that is generally in excess of fifty additional years. Such buildings, however, will be sold subject to that lease and we believe that the land should be valued based upon the fair market value of the land that is subject to the ground lease, which is the same way that land owned in fee simple would be valued. We also note that in many cases, the terms of the ground lease or other regulatory restrictions imposed in connection with the building's financing will limit the use of the building

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to low-income housing and that such restrictions should be taken into account in valuing the building and the land.

2) Do housing credit agencies have authority to provide more stringent requirements than the provisions contained in Section 42(h)(6)(F) and specifically, may such agencies impose a fair market value cap that would restrict any qualified contract price to the fair market value?

Response: The Coalition believes strongly that housing credit agencies have no authority under Section 42(h)(6)(F) or otherwise to impose a different formula for computing the qualified contract price and no authority to impose a fair market value limitation on such price. As noted earlier in our comments, the Congress carefully considered how to calculate the qualified contract price. That determination was a compromise that reflected a balancing of interests between investors concerned that they be able to recoup their equity investment and tenant advocates who wished to extend the low-income use restrictions. The result of its careful deliberations on this subject is the calculation set forth in Section 42(h)(6)(F). Had the Congress desired to set or limit the price to the fair market value, it would have done so, but it chose instead to set the price as set forth in Section 42(h)(6)(F). There is absolutely no legislative history of which we are aware that would support the proposition that the Congress intended a fair market value limitation. The flush language that the Service cites in Section 42(h)(6)(E), which allows for "more stringent requirements," relates to a wholly different concept—when the extended use period will terminate. Indeed, the language is very clear—the "more stringent requirements" relate to "Subclause II" of Section 42(h)(6)(E), which deals with the date for termination of the extended use period; it has nothing to do with the qualified contract price, which is set forth in Section 42(h)(6)(F). The Coalition recognizes that housing credit agencies have the authority, which has been regularly exercised, to terminate the extended use period at a date later than contemplated in Section 42(h)(6)(E). Indeed, our experience is that it is impossible to obtain a housing credit allocation in most states unless the owner agrees, in its application, to extend the termination of the extended use period. However, housing credit agencies have no ability to change the calculation of the qualified contract price, nor does the Service have the ability through regulations to alter the statutory language on the subject.

We also note that Section 1.42-18(c)(1) of the Proposed Regulations provide that housing credit agencies would have the right to reduce the fair market value of the building (presumably meaning the non low-income portion) if, after a reasonable period, no buyer has made an offer or market values have adjusted downward during the one year period. We question the statutory authority for giving housing credit

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agencies such a right. Moreover, it is unclear as to how agencies would decide precisely when to reduce the acceptable price and by what amount. Would the agencies be required to adjust the price upward if market values were determined to have increased? Accordingly, we object to giving housing credit agencies the right to adjust the fair market value during the one-year period.

SECTION II—COMMENTS ON SPECIFIC PROVISIONS OF THE PROPOSED REGULATIONS

1) **Definition of "outstanding indebtedness".** Proposed Section 1.42-18(c)(3)(i) would define "outstanding indebtedness" for purposes of calculating that aspect of the qualified contract price as being limited to the amount of the qualified building costs as defined in paragraph (b)(4) of that Section. A qualified building cost is limited to costs includable in eligible basis and as explained in the Preamble, the proposal would exclude the proceeds of any refinancing or additional mortgages in excess of such qualifying building costs. Moreover, Proposed Section 1.42(c)(3)(ii) would require the discounting of any debt which has an interest rate below the applicable Federal rate ("AFR") under Code Section 1274. There is absolutely no statutory authority, nor legislative history, to indicate that the Congress intended that outstanding indebtedness be limited to qualified building costs or that debt with an interest rate below the applicable Federal rate be discounted as proposed. Had Congress intended either result, it would provided language to this effect. Contrast the language of Code Section 42(i)(7)(B)(i), enacted at the same time as the qualified contract provisions, which deals with the minimum purchase price under the exercise of a right of first refusal. In that situation, the Congress explicitly excluded debt that was incurred in the five year period prior to the sale to the tenants. Congress could have chosen to limit the debt to be taken into account in calculating the qualified contract price but unlike the provisions governing the minimum price for rights of first refusal, it did not do so. The Service's attempt to reduce the qualified contract price in a manner not contemplated by the Congress is not justified by the law nor the language allowing the Secretary of Treasury to issue regulations to prevent the manipulation of the qualified contract price. There is no abuse occurring here that the Proposed Regulations are preventing. Moreover, as a practical matter, it is virtually impossible to trace whether a particular cost of the development was paid for by debt or equity as these funds are fungible during the development and construction of a project.

In our experience a substantial number of projects are financed with debt which bears interest at rates below the AFR and in fact, these projects would not have been financially feasible without such favorable interest rates. In most instances, the buyer of the project would acquire the property subject to the debt and the residents of the project would

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continue to benefit from the lower debt service expense that permits the new owner to provide lower than market rental rates. Both the seller and the buyer would treat the full, undiscounted amount of the debt as part of the purchase price under general tax principles and there would generally not be any reduction to basis. Nor would there be any upward adjustment if the financing had an interest rate that was above the AFR and such financing was required to be assumed. Assuming the buyer acquired the property and did not assume or take subject to the below AFR financing, the seller would still have to pay off the full principal amount of the loan even if it received only the discounted amount as part of the purchase price. This would require that some of the purchase price that was attributable to the equity investment would have to be utilized to satisfy the below AFR financing. We see no policy justification for this result.

2) **Definition of adjusted investor equity.** Section 1.42-18(c)(4) of the Proposed Regulations also limits the adjusted investor equity to the amount of cash invested in qualifying building costs. The proposal is inconsistent with the statutory language which provides that the adjusted investor equity shall only be taken into account to the extent that such amount is reflected in the "adjusted basis of the project". We believe that the "adjusted basis of the project" should be determined in accordance with Section 1012 of the Code, i.e., the adjusted basis is the cost of the project. Accordingly, this would include land, real property, personal property, site improvements and intangible assets and not just qualifying building costs as defined in the Proposed Regulations. Moreover, in our view, tracing of capital contributions to specific uses of funds should not be required as the various sources of funds in a project, including debt and equity, are generally fungible and it will be impossible to trace, particularly for transactions that closed fifteen years ago. Finally, adjusted basis should not reflect adjustments to basis such as those required under Section 50(c) of the Code for rehabilitation or other investment credits or adjustments to eligible basis allowed for projects located in difficult development areas or qualified census tracts under Section 42(d)(5)(C) of the Code.

3) **Rejection of a contract by an owner or its failure to act.** Under Section 1.42-18(a)(ii)(B) of the Proposed Regulations, if the housing credit 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 extended use commitment. For reasons explained in Section III below in these comments, we believe that the Service has paid insufficient attention to a number of procedural matters pertaining to the qualified contract process and that this statement does not adequately deal with this issue. If an owner rejects or fails to act on a contract presented by the housing credit agency

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because the qualified contract price is incorrect or because the presented contract contains unreasonable terms and conditions, we do not believe that the building should automatically remain subject to the extended use commitment. As explained below, a process needs to be developed as part of the Proposed Regulations to deal with disputes between the parties as to what constitutes a qualified contact or a bona fide contract.

4) **Determination of cash distributions from or available for distribution from the building.** Proposed Regulation 1.42-18(c)(6) provides that the qualified contract price is reduced by all distributions from the project to owners or to related parties to owners within the meaning of Code Sections 267(b) or 707(b) and by all reserve funds available for distribution at the time of closing.

Without legislative history, this has been perhaps the least understood concept in the qualified contract context. As a general matter, we believe that the Congress intended to look at what the owners (i.e., partners in a limited partnership, or members of limited liability companies, which are typically the owners of these projects) were distributed or could have been distributed in cash throughout the life of the partnership. We have reviewed the written policies of several of the housing credit agencies and believe that the Florida Housing Finance Corporation's approach to this point best reflects what we believe the Congress intended. For this purpose, Florida calculates all cash payments and distributions from net operating income, i.e., income remaining after payment of operating expenses, debt service and payments into reserves. The distributions to be taken into account include amounts paid to partners or affiliates as fees payable from operations (including, but not limited to, investor fees, partnership management fees, incentive management fees and guaranty fees) and amounts distributed as a return of capital, such as refinancing proceeds. However, the agency will not reduce the qualified contract price by payments of deferred development fees to the extent that the amount of such fee was within that agency's guidelines, even if paid to a related party (as is often the case). In addition, we believe that repayments of project expense loans, including interest, made by partners or affiliates of partners should not be treated as distributions that would reduce the qualified contract price. Of course, regular cash distributions to partners would serve to reduce the qualified contract price.

Florida also interprets the "available for distribution" language to include all cash held in partnership reserves and other accounts, the distribution of which to the owners is not prohibited by mortgage restrictions, regulatory agreements or similar third-party contractual provisions. We believe it is important to clarify in the Proposed Regulations that it is only the amount of reserves that are distributable to the owners which would serve to reduce the qualified contract price. To the extent that a reserve amount is required by such contractual

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provisions to remain with the property after sale, such reserve would not be computed in the qualified contract price. An amount currently held in such a restricted account that will become unrestricted and available for distribution on or before the expiration of the one-year qualified contract period is listed as available for distribution. We endorse the approach taken by the Florida housing credit agency and would urge the Service to consider adopting that approach.

5) **Administrative responsibilities of the Agency.**

While we do not object to the provisions of Proposed Regulation Section 1.42-18(d), for the reasons explained in Section III below, we believe that much more attention needs to be paid to outstanding procedural concerns and that this aspect of the Proposed Regulations does not adequately address administrative matters.

SECTION III—MATTERS NOT ADDRESSED IN THE PROPOSED REGULATIONS

1) **What constitutes a "bona fide contract"?** Although Black's Law Dictionary defines the term as "a contract in which equity may intervene to correct inequalities and to adjust matters according to the parties' intention", that definition has little relevance or meaning in the context of Section 42. A typical modern contract for the purchase and sale of real estate is often a lengthy, complicated and heavily negotiated document. In addition to negotiation on a sales price (which price is prescribed under the provisions of Section 42(h)(6)(F) in these circumstances), there are a myriad of other provisions that the parties will typically negotiate. For example, provisions often include representations and warranties on a number of topics, the scope of due diligence and the time frame for permitting due diligence review, the manner in which the purchase price will be paid, contingencies permitting the termination of the contract, provisions concerning a default by the parties, the amount of down payments, risk of loss during the contract period and so forth. Even in a particular state, there are seldom "form" purchase and sale agreements; indeed within a state, different regions may have substantially different forms and very different local business customs that guide the practice.

The Code provides that the extended use period terminates if the housing credit agency does not "present" a qualified contract (i.e., a bona fide contract) within the one-year period after a written request is made. But what if the presented contract contains terms and conditions (leaving the price aside for the moment) that are completely unreasonable, particularly given standard real estate practice in that jurisdiction? Suppose, for example, that the buyer arranged for by the state insisted that the seller guarantee for ten years that there will be a minimum of $1,000,000 of net cash flow each year even if the property is currently

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barely breaking even financially. Does that constitute a bona fide contract? If the owner does not agree to that term, can the housing credit agency argue successfully that its refusal to accept the presented contract results in the continuation of the extended use period?

Conversely, for example, it is common in most jurisdictions for the seller to certify the accuracy of the current rent roll; suppose the seller refused to take that simple step? Would the seller's refusal to accept the presented contract under these circumstances allow the seller to claim that the extended use agreement should be terminated? The examples of potentially unreasonable or bad faith dealing can go on and on but the point is that these are very complex transactions where the business practices will vary in different jurisdictions and the facts and circumstances of each transaction are likely to be very different. Defining a bona fide contract that would fit substantially different and myriad circumstances is simply not possible.

Moreover, despite the statutorily determined price to be set forth in the qualified contract, it is possible that the housing credit agency and the owner may disagree over the calculation of that price.

An essential question is whether a presented contract that fails to contain reasonable and standard terms can be considered bona fide, regardless of whether it is the buyer or the seller that is being unreasonable. Our position is that such a contract, if presented by the housing credit agency or its buyer, should not be treated as bona fide. In our view, if the state agency presented such a contract, then it would not have met the condition set forth in Section 42(h)(6)(E)(i)(I)(ii) and the extended use period should be allowed to terminate pursuant to Section 42(h)(6). The simple act of presenting a contract that is not bona fide should not result in a continuation of the extended use period.

On the other hand, if the state agency presented a reasonable contract that should be treated as bona fide, but the owner refused to act reasonably in response, then in our view, the owner should not be released from the extended use period. In other words, the Coalition believes that neither side should be able to act unreasonably in order to effectuate the extension or termination of the extended use agreement.

The most important question in this area is how to resolve fairly and efficiently disputes over what constitutes a bona fide contract where the parties are not able to agree on terms or the price to be paid under the Code. The Coalition's suggestion is to invoke binding arbitration, conducted in accordance with nationally recognized rules of arbitration such as the American Arbitration Association, if the parties are not able to agree after a certain period of time on the terms of a qualified contract. A substantial advantage of arbitration is that the opposing parties are much more likely to be reasonable in their negotiations if they face the possibility of an arbitration proceeding. A trained and experienced arbitrator will be able to determine which of the parties is acting reasonably (and if the dispute is over the price, the amount to be paid)

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and whether the contract being presented or rejected is bona fide in light of its terms and conditions.

In considering this suggestion, the Coalition thought about other alternatives. Despite our substantial experience in real estate, we were unable to devise a way of defining the term "bona fide contract" that would fit all circumstances. If the parties are able to agree, the issue resolves itself and the threat of arbitration is likely, in our view, to resolve many disputes. But in those cases, which could be numerous, where the buyer and seller are not able to agree on whether the contract is bona fide or the price, then having a conflict resolution process in place will help resolve disputes relatively quickly and efficiently.

Accordingly, we urge the Service to adopt a binding arbitration process to determine whether a presented qualified contract is a "bona fide contract" if the parties to the transaction are not able to agree.

2) **What is a reasonable time to acquire the property after the qualified contract is entered into?** Typically, the purchase and sale agreement will spell out the date on which the closing will occur and will permit extensions of that date under certain circumstances or if requested by one of the parties. However, facts and circumstances will dictate what is reasonable in any given situation and that may vary substantially from transaction to transaction. Like the questions posed above concerning bona fide contracts, we believe that if the parties cannot agree as to what constitutes a reasonable time to close, that this matter also be subject to binding arbitration.

Moreover, if the buyer does not acquire the project within the agreed upon timeframe due to its default, then the extended use period should be treated as terminated (unless the owner elects to allow the housing credit agency to present another contract). The Code contemplates that the extended use period terminates if the housing credit agencies does not present **"a"** qualified contract in response to the owner's request. (See Section 42(h)(6)(E)(i)(II)). In our view, this language must be read literally—"a" contract means one contract. If the buyer presented by the housing credit agency defaults in its obligation to acquire the project, the agency should not be given multiple chances to present additional contracts (absent the owner's election to do so); otherwise, the statutory scheme can be frustrated as one contract after another is presented and the extended use period is prolonged indefinitely.

3) **How should the fair market value of the nonlow-income portion of the building be calculated?** We believe that qualified real estate appraisers should determine fair market value. However, it is only fair and equitable that neither side be able to dictate the identity of the appraiser since in our experience, different appraisers, even though licensed and qualified, may differ in their conclusions. If

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the parties are able to agree on the identity of an appraiser, there will be no issue. However, if the parties each wish to engage their own appraiser, and the value determination is different, the resulting conclusion as to value should either be the average of the two appraisers or the two appraisers should jointly appoint a third appraiser whose determination of fair market value would be binding on the parties. These techniques are generally accepted in the real estate industry.

4) **What information and documentation can the housing credit agency require when an owner makes a written request of the agency to locate a buyer?** We expect that housing credit agencies will legitimately ask owners to submit certain information and documents about the project in order for the agency to seek potential buyers. However, we are also concerned that housing credit agencies may impose unreasonable and unnecessary information requirements on owners in making requests to find a buyer. If such information requests are unreasonable and burdensome, then the owner's statutory right to make a request can be effectively frustrated.

Once again, we believe that the approach established by the Florida housing credit agency with respect to information and documents to be submitted in making a written request is a good example that the Service could adopt. The documents and information required to be submitted by Florida are as follows:

(i) a calculation of the qualified contract price;
(ii) a thorough narrative description of the project, including amenities;
(iii) a description of the regulatory restrictions, if any, applicable to the project;
(iv) photographs of the exterior and representative apartment units and buildings;
(v) financial operating statements for the project for the prior 12 months;
(vi) a current rent roll;
(vii) copies of any leases if any portion of the land or improvements are leased.

In addition, Florida requires the payment of a fee. While we do not expect the Service to regulate the amount of such a fee, it should be reasonable.

We urge the Service to state in its regulations that housing credit agencies which impose substantially more burdensome information and documentation requirements on owners will forfeit their right to require owners to go through the qualified contract process. Finally, the one year period should commence when the reasonably required information is submitted by the owner.

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5) **How can the qualified contract price be calculated, particularly if the project owner does not have complete tax and financial records for the prior 15 years?** Unfortunately, we have discovered that many project owners have not maintained their financial records and tax returns for the full 15 years, making the calculation of cash distributed or available for distribution difficult to determine with complete precision. To address this situation, the Coalition would suggest that the accounting industry, working together with housing credit agencies, develop an agreed upon procedures report where the accountants would draw upon the best available documents and resources in order to make these determinations. The accounting industry has taken a similar approach in developing cost certification and "ten percent test" reports for housing credit agencies.

6) **What is meant by the phrase "only to the extent there was an obligation to invest such amount [i.e., the aggregate amount of cash taxpayers invested] as of the beginning of the credit period"?** It is very common in the housing credit industry to provide in the governing documents (generally an agreement of limited partnership or a limited liability company operating agreement) that the investor's capital contributions will be subject to adjustment, based upon the amount of or timing of delivery of Housing Credits. The amount and timing of Housing Credits are usually determined by the accountants after completion and lease up of the project. These agreements are generally executed and are in place before the beginning of the credit period, although the final adjustments to the capital contributions may not be made until after the commencement of the credit period due to the timing of the accountants' determination in relation to the beginning of the credit period. Moreover, payment of these capital contribution adjustments may be contingent on the investor having sufficient funds to make the payment. These provisions are generally referred to as "adjuster clauses". We believe it is fair and equitable and within the Congress's intent, to interpret the "obligation to invest" language as including capital which is contributed after the commencement of the credit period as a result of an adjuster clause, provided that the adjuster clause was in place prior to the start of the credit period.

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The Affordable Housing Tax Credit Coalition appreciates the opportunity to submit these comments. Under separate cover, we are submitting an outline of topics to be discussed at the public hearing on these Proposed Regulations. We stand ready to work with the Service in this or any other matter pertaining to the Housing Credit. Thank you for your consideration of our views.

Very truly yours,

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Year 15 Nonprofit Transition Strategies For LIHTC Properties

SECTION I
Bios

Enterprise™

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As director for Enterprise Community Investment, Inc. (Enterprise), Mr. Griffin is responsible for the disposition management of Enterprise's expiring low-income housing tax credit (LIHTC) projects. He has been instrumental in developing the policies, procedures and training for the Year 15 program and has completed several property transitions. Mr. Griffin is also responsible for problem resolution for properties in the portfolio, which requires focused attention beyond Enterprise's customary asset management. When necessary, he provides support and technical assistance to Enterprise's partners to resolve organizational and/or specific project issues.

Prior to joining Enterprise in July 2001, Mr. Griffin was the director of operations with HAI Management, Inc., a large mid-Atlantic property management firm specializing in affordable housing. He served with HAI Management for 13 years.

Mr. Griffin is a presenter at national and regional forums on the Year 15 disposition process and has been involved with the LIHTC program since its inception in 1987.

Mr. Griffin is a licensed Real Estate Salesperson in the state of Maryland, a Housing Credit Certified Professional and holds a bachelor's of science degree in Business Administration from Bridgewater College in Bridgewater, Va.

03.20.07

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As assistant general counsel and chief tax counsel with Enterprise Community Investment, Inc. (Enterprise), Ms. O'Conor provides legal and technical tax guidance to various Enterprise departments, including Asset Management, Syndication, Investment Management and Fund Analysis.

Ms. O'Conor joined Enterprise in 2001 as syndication counsel. Her work has involved providing legal and tax advice on issues involving partnership taxation, low-income housing tax credit compliance, historic tax credit matters, project workouts, and dispositions of ownership interests.

Ms. O'Conor previously worked in public accounting for the Reznick Group, and for Ernst & Young. She is a frequent speaker at Enterprise-sponsored events and has participated as a panelist at a number of professional and industry forums. She practiced as a certified public accountant and is an attorney with a master of laws in taxation from Georgetown Law Center.

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