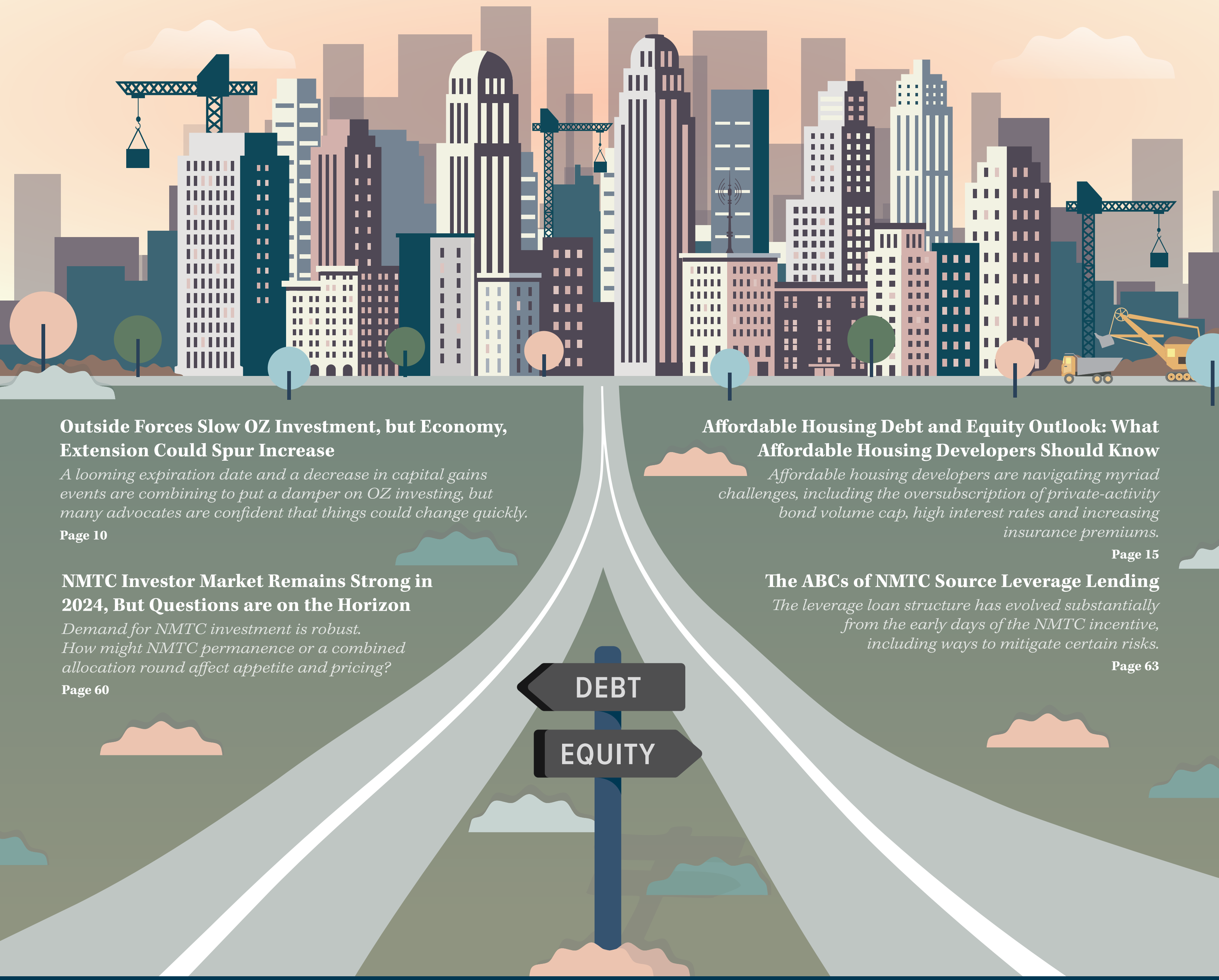
EXCERPT

NOVOGRADAC
Journal of Tax Credits™

June 2024 • Volume XV • Issue VI
Published by Novogradac

Debt and Equity Market Updates



Outside Forces Slow OZ Investment, but Economy, Extension Could Spur Increase
A looming expiration date and a decrease in capital gains events are combining to put a damper on OZ investing, but many advocates are confident that things could change quickly.

Affordable Housing Debt and Equity Outlook: What Affordable Housing Developers Should Know
Affordable housing developers are navigating myriad challenges, including the oversubscription of private-activity bond volume cap, high interest rates and increasing insurance premiums.

NMTC Investor Market Remains Strong in 2024, But Questions are on the Horizon
Demand for NMTC investment is robust. How might NMTC permanence or a combined allocation round affect appetite and pricing?

The ABCs of NMTC Source Leverage Lending
The leverage loan structure has evolved substantially from the early days of the NMTC incentive, including ways to mitigate certain risks.

LIHTC Conference Panel Explores Complexities of Year 15

NICK DECICCO, SENIOR WRITER, NOVOGRADAC

Knowing options and negotiation were recurring themes during the "Getting Ready for Year 15" panel at the Novogradac 2024 Affordable Housing Conference May 2 in San Francisco.

Novogradac partner Thomas Stagg, CPA, moderated the panel, which covered topics including valuation, exit timing, resyndication, right of first refusal (ROFR) and more.

Year 15 is low-income housing tax credit (LIHTC) nomenclature for the end of the tax credit compliance period after 15 years. The moment brings up issues regarding whether managers and owners want to retain their properties or exit ownership.

Image: Novogradac
Jeff Weiss, second from right, president of Hunt Capital Partners, speaks during the "Getting Ready for Year 15" panel May 2 at the Novogradac 2024 Affordable Housing Conference in San Francisco. Novogradac partner Thomas Stagg, left, moderated the panel and was joined by Philip Porter, second from left, senior vice president and head of acquisitions for Enterprise Housing Credit Investments, and Tuam Pham, right, partner with the law firm Downs Pham & Kuei.

One panelist, Tuan Pham, partner at the law firm that bears his name, Downs Pham & Kuei, said that knowledge is power when it comes to Year 15 options.

"I kept talking about knowing your rights and knowing your options in your documents. I think that's important," said Pham. "But from what we're hearing up here, it's that that's the basis of your discussion with your [partners]."

Valuation

Determining the value of the property is vital to knowing one's options as Year 15 approaches, said Jeff Weiss, president of Hunt Capital Partners. The goal is to come to an agreement that provides an opportunity for one or all of the partners to exit the transaction. "Not to get in fights with your partner," said Weiss.

Weiss said the primary question is what is being valued, whether that's the property or the limited partner interest.

"Is it the option for the interest in the partnership or the property itself?" said Weiss. "We might transact on the interest even if the options are for the property."

What follows from there, Weiss said, is a discussion about how the partners value it, whether that's an appraisal, a broker's opinion of value or taking the property to market and selling.

Weiss noted that despite the verbiage of the term "limited," a limited partner's control isn't all that limited if they have to sign off on the transaction.

"If you can't make major decisions without the limited partner's approval, it's hard to argue they have limited control [to an extent that value would be diminished]," said Weiss.

Pham said it's important to know what's in the partnership agreement and what was agreed at the outset of the development.

"That's all part of the advice of go talk to your partner, be good with your partner because that's not something that you can go in and demand," said Pham.

Negotiations may be based on the value in the partnership. Stagg clarified that a lack of value often means a property's soft debt has ballooned, so even though its value has risen, there's so much debt that there's no residual value.

Image: Novogradac
Philip Porter, left, senior vice president and head of acquisitions for Enterprise Housing Credit Investments, speaks during the "Getting Ready for Year 15" panel May 2 at the Novogradac 2024 Affordable Housing Conference in San Francisco. Jeff Weiss, middle, president of Hunt Capital Partners, and Tuam Pham, partner with the law firm Downs Pham & Kuei, joined Porter as panelists.

"If there's no value, [it's a question of] how do we get you out in a tax efficient manner that involves the least amount of lawyer time?" said Phillip Porter, one of the panelists as well as senior vice president and the head of acquisitions at Enterprise Housing Credit Investments.

Appraisals

When the panel discussed appraisals for properties before Year 15, Porter said it's important not just to get an experienced appraiser, but one who knows the intricacies of the LIHTC and affordable housing. Such an appraiser will know what net operating income can be achieved and then make a judgment as to how the market values a property.

"They need to understand what the regulatory requirements of the deal are," said Porter.

Weiss said that he's seen some exits try to exclude Housing Assistance Payments (HAP) from the value of a property. Porter said that Enterprise has occasionally seen efforts by sponsors to devalue the asset through discounting net operating income provisionally, though not as frequently. Pham said one transaction with HAP contracts involved heavy negotiations, underscoring Pham's later point about the value of communication.

Liquidation

On the topic of liquidation, the panel discussed how liquidation of a limited partner can skew the cash flow waterfall.

"If you have a cashflow waterfall that's a 10-90 distribution, 10% to the limited partner and 90% to the general partner, liquidation starts to move those numbers in the opposite direction," said Weiss. "I am pushing our staff to have open conversations, to discuss it. Liquidation and the way agreements work is a starting point."

Stagg said that while many partnership agreements have a liquidation provision in them, he acknowledged that some liquidations could lead to a 50-50 split, which can be controversial. Ultimately, Stagg noted the takeaway from the liquidation discussion is understanding your limited partner's capital account.

Timing of Exit

Knowing the needs and goals of the parties involved in the transaction is important to the timing of the exit, the panelists agreed.

Weiss said the first two questions are what do the documents proscribe and what are the investor's goals around timing? Weiss said Hunt's primary goal as a syndicator is to facilitate a transaction that is a win-win for the tenants, general partner and limited partner. The timing of any desired impact is based on the motivations of each investor coupled with market conditions.

"By leaving earlier, it may help them with their capital reserves and it may allow them to invest in new deals," said Weiss. "My theme is communication with your syndicator."

Porter said Enterprise has pursued early exits in situations where rising property taxes are pushing properties toward foreclosure. In these instances, Porter said, Enterprise has sought to transfer its interest to a nonprofit partner to qualify for an exemption to sustain the property's operations.

Resyndication

Stagg said the discussion about resyndication hinges on a property's value allocation, the consideration of whether a property is a primary syndication asset or if it's able to go to a true market sale. Weiss said Hunt looks at properties in a similar fashion, sometimes seeing resyndication as an opportunity to structure a transaction differently. Weiss said a primary goal is for the parties to reach agreement on a price.

When Stagg asked the panelists when resyndication is the right move, Pham said owners and managers should look at what the state's allows in its qualified allocation plan (QAP), urging owners and managers to confirm that recapitalization is in their state's regulations. Weiss agreed about the importance of QAPs.

"The qualified contract is dead," said Weiss. "Nobody's dealing with that."

Weiss said the minimum extended use period is 30 years in many states and even longer in California, meaning longer-term affordability.

Another important question is the level to which a development requires rehabilitation or improvement. If the level of rehabilitation needed is substantial, it may not be feasible to achieve without a new round of tax credits.

"If it's substantial, why not get new tax credits to pay for that rehabilitation and go with a resyndication?" said Weiss. "You're not giving anything up. You're just going to get equity to pay for those rehabilitation costs instead of using loan proceeds."

Porter cautioned developers to learn about the previous owners of a property due to the related-party rule, which could complicate the placement of equity to preserve the acquisition credits and limit the residual value available to the general partner after resyndication.

Right of First Refusal

Pham said some in the affordable rental housing community see ROFR as a purchase option, an idea he hoped to dispel.

"A purchase option means you get to elect to buy it," said Pham. "A right of first refusal means that some folks treated it as an option. It's not. It means that you get the first opportunity to match if someone else makes an offer."

Weiss said a purchase option must be at fair market value, while a ROFR goes to a nonprofit developer at bargain purchase price. A nonprofit can buy a property for the minimum price of debt plus exit taxes attributable to the sale with a ROFR. Dispelling another misnomer, Stagg said nonprofits don't automatically have a ROFR. A ROFR must be baked into the initial agreement on a development.

Clearing up yet another notion, Weiss noted that a ROFR can only be for a property. "It doesn't mean you don't transact on the interest, but the ROFR is only for the property," said Weiss.

Porter noted that for many dispositions that liquidation could drive the reserves to the limited partner to one degree or another and that should be part of the discussion as a sponsor approaches Year 15.

Communication

All of the panelists agreed that knowledge is power when it comes to Year 15.

"It starts year one, day one when you're negotiating the partnership agreement," said Weiss, who urged members of the LIHTC community to have difficult conversations sooner rather than later with their development partners. "Talk to your counsel. Talk to your partner. Bring up your concerns."

Pham said that the LIHTC has existed for so long now that many members of the community have experience and institutional knowledge about Year 15 that was unavailable in the initial stages of the credit in the 1980s, when such a moment was a future concept.

Porter emphasized the importance of knowing your partners, saying who the syndicator or direct investor is can be as important as the documents signed.

"When you think about who your partner is, you need to think about who they are, what's their business, is it aligned with yours and how have they behaved over time?" said Porter.

NOVOGRADAC®

CONTACT

CORRESPONDENCE AND EDITORIAL SUBMISSIONS
Teresa Garcia
teresa.garcia@novoco.com
925.949.4232

ADVERTISING INQUIRIES
Christianna Cohen
christianna.cohen@novoco.com
925.949.4216

ISSN 2152-646X