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Preparing For Year 15: Know the Landscape

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As an increasing number of low-income housing tax credit (LIHTC) projects approach the end of their 15-year tax credit compliance period, the associated issues are at the forefront for all players involved in an LIHTC transaction: general partners, developers, syndicators, investors, lenders and governmental agencies. Suffice it to say, it's never too early to prepare and plan for the project's life after year 15. In fact, the planning and preparation should have begun before the project was even placed in service. This article will identify many of the issues that will need to be analyzed in preparation for year 15. It is the first in a series that will examine the issues and challenges facing all parties in connection with year 15. Future articles in the series will expand on each of the issues discussed below.

Know Your Deal

Many things may have changed since your LIHTC project was placed in service. Project parties may have changed. For example, investors may have transfered their ownership interests or limited partners may have removed general partners. Furthermore, the project's market may have changed, in some cases, drastically. What was a thriving market a decade ago may barely have a pulse now. You will need to run varied analyses to determine your project's value and the financial viability of the project under a number of scenarios. The project's value may be the most significant factor in determining the exit for project participants. Finally, the project's performance may have changed or the property may have never reached its projected performance level. Staying familiar with the project, or re-familiarizing yourself with the project will help you determine the future of your project after year 15.

Know Your Documents

The documentation governing a LIHTC project is voluminous. The partnership documents (including, among other documents, the partnership agreement and purchase option/right of first refusal agreement), loan documents (especially documents governing so-called "soft loans," which may include ongoing affordability and set-aside requirements, along with transfer restrictions), any governing documents required by the U.S. Department of Housing and Urban Development (HUD) (for example, a regulatory agreement), and LIHTC documents (especially the extended use agreement required under Section 42(h)(6) of the Internal Revenue Code (IRC)) may all contain provisions that will affect the potential exit strategies available to the project partners, as discussed below.

Know Your Exit Strategies

As discussed above, the various documents governing a LIHTC project and its participants will set forth several exit strategies for the project partners. Each strategy will have its own tax consequences. Common exit strategies include:

- Nonprofit right of first refusal: IRC Section 42(i)(7) affords certain nonprofit entities the right to purchase a LIHTC project at a predetermined price. This right is normally set forth in the partnership agreement or a separate, stand-alone agreement.
- General partner option to purchase: Partnership agreements often provide the general partner with an option to purchase the project or the limited partner's interest in the partnership for fair market value.
- Continued compliance sale: Partnership agreements often provide the limited partner with the right to

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require the partnership to sell the project subject to the extended use agreement.

- Compliance termination sale: IRC Section 42(h)(6) allows the limited partner to ask the partnership to request that the credit agency arrange for the sale of the project pursuant to the "qualified contract" process. If such a sale cannot be completed, the extended use agreement may be terminated.
- Investor put right: Partnership agreements often allow the limited partner the right to put its interest to the partnership or the general partner for a nominal amount or fair market value.
- Resyndication: At year 15, the project may be recycled for rehabilitation and acquisition credits, so long as the minimum rehabilitation requirements under IRC Section 42(e)(3)(A) and the acquisition requirements under IRC Section 42(d)are met.

Know When You Can Exit Before Year 15

The Housing and Economic Recovery Act of 2008 repealed the requirement that a partner who sells its interest in an LIHTC project before the end of the 15-year tax credit compliance period post a recapture bond. The requirement is only waived, however, if it is reasonably expected that the project will continue to be a qualified low-income project for the remainder of the tax credit compliance period. As a result, an early exit from a LIHTC project is a potentially viable option for a limited partner.

Know the Potential Tax Consequences at Year 15

At year 15, a number of tax consequences arise for project partners. Most notably, project partners may have liability for exit and transfer taxes.

- Exit taxes: Exit taxes arise when a limited partner's losses exceed its capital contributions, resulting in a negative capital account. In many transactions, the general partner is obligated to pay the limited partner's exit taxes. Many general partners, especially nonprofit general partners, are concerned about exit tax liability and look at various strategies for mitigating or eliminating exit taxes. For example, a partner may mitigate liability by reducing the limited partner's loss percentage after the close of the credit period.
- Transfer taxes: Many jurisdictions (state, county and local) impose transfer taxes upon conveyance of the project or a limited partner interest therein. There are, however, various tax exemptions available. A careful analysis of applicable transfer taxes is an important aspect of any year 15 analysis. The obligation to pay transfer taxes should be explicitly set forth in the project partnership agreement. If not, significant negotiation will be necessary to identify the responsible party.

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Conclusion

The discussion above barely scratches the surface of the potential universe of issues that may arise in connection with year 15. As such, it's never too early to start identifying and analyzing issues.

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