Low-Income Housing Tax Credits and Planning for Year 15

Presenter – Shawn Harrigan, CPA

DIXON HUGHES GOODMAN LLP

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Year 15, Ready or Not, here it comes!

Overview

- Background
- Number of LIHTC properties reaching Year 15.
- Why all the fuss about Year 15?
- Importance of planning for your deal – Success equals planning & organization
- Key points for Year 15
- Common Year 15 exit strategy options
- Year 15 trends
- GP concerns

Background

- (LIHTC) – Low-Income Housing Tax Credit
- Program enacted as part of the TAX Reform Act of 1986.
- Congress created this tax credit program as incentive for developers to build more affordable housing.
- Program has a tax credit compliance period of 15 years.
- Nearly 30 years have passed since the inception of the program.

Year 15 – Definition of the initial compliance period

- The period begins with the first taxable year that credits were taken for the first building of the property placed in service and ends on the 15th year from the date that last building is placed in service.

Number of LIHTC Properties reaching Year 15

- As of June 18, 2015, HUD's Low-Income Housing Tax Credit Database contains information on approximately 40,500 properties.
- 2.6 million housing units have been placed in service between 1987 and 2013.
- One third of all multifamily rental housing built between 1987 and 2006 were LIHTC units.
- An approximate 1,000,000 affordable housing units will reach the end of their 15-year compliance period by the end of 2020.

Why all the Fuss about Year 15

- Initial tax credit compliance period expires the last day of the 15th year since credits were taken.
- Can transfer ownership in year 16 without recapture of the credits.
- Generally investors are ready to dispose of their interest in year 16.
- Partners must decide the future of their property.

Success = Planning & Organization

- Planning takes time and is continuous.
- Success is all in being proactive which requires planning, organization, and continuous monitoring.
- Procedures for an investors exit are an important part of Year 15 planning for LIHTC deals.
- Exit strategy should begin with the underwriting process.
- Don’t underestimate the value professionals with experience bring to table.

Key Points for Year 15

- Evaluate the state of the property.
- Know your deal.
- Know the key players and stakeholders.
- Know your documents.
- Know when you can exit and available exit strategy options.
- Seek the guidance of experienced professionals.
- Develop a customized action plan.

Evaluate the state of your property

- Evaluate the financial health of the property.
- Assess the physical condition.
- Evaluate market conditions.
- Assess the current fair value.
- Create realistic cash flow projections.
- Review the regulatory agreement.
    - Future restrictions on operations/refinance.
    - Extended compliance period requirements.

Know Your deal

- Stay familiar and up to date with the property.
- Realize many things can change over the course of 15 years.
- Monitor the market.
  - Has the property consistently operated in a stabilized occupancy?
  - Have concessions been necessary to obtain a stabilized occupancy?
  - How difficult is it to find income-eligible tenants with a good rental history?
- Operating performance will have significant impact on the property's value.
- Tax credit compliance issues may arise.
- Run financial analysis under several scenarios to determine property's value as this could be the most significant factor for selecting the appropriate exit strategy.

Know the key players and stakeholders

- Include all of the following:
  - Developers/general partners
  - Investors/limited partners
  - Syndicators
  - Lenders
  - Housing Finance Agencies

Know Your documents

- Documentation includes all of the following:

  - Partnership/Operating agreement, including all amendments.
  - Purchase Options and Right of First Refusal Agreements.
  - Partnership Interest Option Agreements.
  - A copy of the most recent audited financial statements.
  - Current YTD financials.
  - A copy of the most recent tax return.
  - Partner tax basis schedules or copies of all partnership returns since the origin of the partnership.
  - Depreciation and amortization schedules.
  - Loan and Regulatory Agreements in place.
  - If HUD applies, a copy of the regulatory agreement and HAP/PRAC contract
  - Original Underwriting projections if available.
  - Any current capital need assessments. A schedule of estimated repairs and maintenance items.

Documents continued

- Other LIHTC Documents:

  -Project's awarded application

  -Carryover agreement/application

  -Land-use restriction agreement (LURA)

  -Form(s) 8609

  -Any recent compliance notices for housing finance agencies.

Know when you can exit

- Partnership, loan, and regulatory agreements may contain provisions that limit when a partner can exit

  -In general, IRC 42 does allow for ownership dispositions to occur before the close of the initial compliance period.

  -Before 2008, partners that exited the partnership prior to the end of the initial compliance period were required to post a recapture bond.

  -Housing and Economic Recovery Act of 2008 repealed the bond posting requirement if "it is reasonably expected that such building will continue as a qualified low-income building for the remaining initial compliance period, however the statue of limitations for assessing recapture taxes is automatically extended.

  - Any decrease in qualified basis, the remaining owners are contractually required to contact the IRS in order to limit the potential recapture tax and interest imposed by the IRS and to allow the starting of the clock on the three-year statute of limitations.

  - Important note: The investor cannot simply avoid recapture by exiting the property as recapture risk remains with the investor through the compliance period.

Types of Year 15 exit strategies

- Year 15 early exit
- Bargain sale of property
  - Donation of property
  - Donation of partnership interest
- Sale to a third party
- Qualified contract
- Right of First Refusal to Purchase
- Resyndication
- GP option to purchase
- Foreclosure

Summary of exit strategies

- In general exit strategies can be summarized into three main categories.
- Most common exit strategy involves an ownership change.

1) A transfer or sale of the property or a transfer or sale of an interest in the property.
2) Rehab the property through resyndication or refinancing.
3) Convert the low income property to market rate units.

Current Year 15 Trends

- Approximately 5% of properties reaching Year 15 are converted to market rate housing
- 42% of the properties were re syndicated with tax credits to rehabilitate the property.
- 15% are maintained as affordable rental housing and refinanced without tax credits.
- Approximately 38% pursued other disposition options.

General partner Year 15 goals & concerns

- GP typically own less than 1% interest yet plays a large role in the deal.
- GP is typically the managing member and tax matters partner
- Oversees the day to day operations, compliance monitoring, and financial statement preparation.
- Goals
  - Meet mission – provide affordable housing to low-income persons.
  - Make a profit, continue to grow.
  - Expand reputation as a respectable LIHTC partner.
  - Operate the property at is highest performance.
- Concerns – approaching Year 15
  - Should the GP retain its ownership interest in the property.
  - Should the GP increase its ownership interest in the property.
  - How to minimize the purchase price of the limited partner's interest.
  - How to avoid paying exit taxes of the limited partner.
- Important note: closely monitor capital accounts of all partners, especially the limited partner as Year 15 approaches.

Contact information

Shawn Harrigan, CPA | Manager, Assurance Services
Dixon Hughes Goodman LLP
Direct 804.474.1252

Kevin Rayfield, CPA | Partner
Dixon Hughes Goodman LLP
Direct 336.822.4364

Gary E. Romer, CPA, CGMA | Partner
Dixon Hughes Goodman LLP
Direct 804.474.1233

Paul Young, CPA, MTAX| Partner
Dixon Hughes Goodman LLP
D 804.474.1203