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# The Emerging Issues in the Expiring- Use Affordability Crisis

What Happens When the Community's  
and the Tax Credit Investor's Interests Are  
Not Aligned?

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# OBJECTIVES OF TODAY'S TRAINING

- Understanding “Year 15”
- Spotting key issues and obstacles
- Understanding different exit options
- Applying legal developments
- Reviewing your “Year 15” Checklist
- Q&A





# Understanding “Year 15”



# TAX REFORM ACT AND AMENDMENTS

## 1986 Tax Reform Act

- Provides housing affordable to households earning below 50% or 60% of area median income
- Investors benefit from:
  - Tax credits taken over 10 years (generally)
  - Loss benefits
- Requires investors to hold the investment for 15 years

### Tax Reform Act of 1986

The Tax Reform Act of 1986 was sweeping legislation that included the introduction of the low-income housing tax credit (LIHTC). Here's some more information about the bill.



245 Congressional actions taken

111 Amendments



882 Printed pages for final bill





# OMNIBUS BUDGET RECONCILIATION ACT OF 1989

- Added **extended** low income restriction
- Recorded as a restrictive covenant
- Extended use expires later of:
  - 15 years after the end of the compliance period
  - Date specified by the state
- Can be terminated only through:
  - Foreclosure
  - Qualified contract process
- Opt-out provisions (qualified contract process):
  - 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 (process varies by state) must locate a buyer at formula purchase price if buyer is not found within one year, extended use restrictions are terminated.



# OMNIBUS BUDGET RECONCILIATION ACT OF 1990

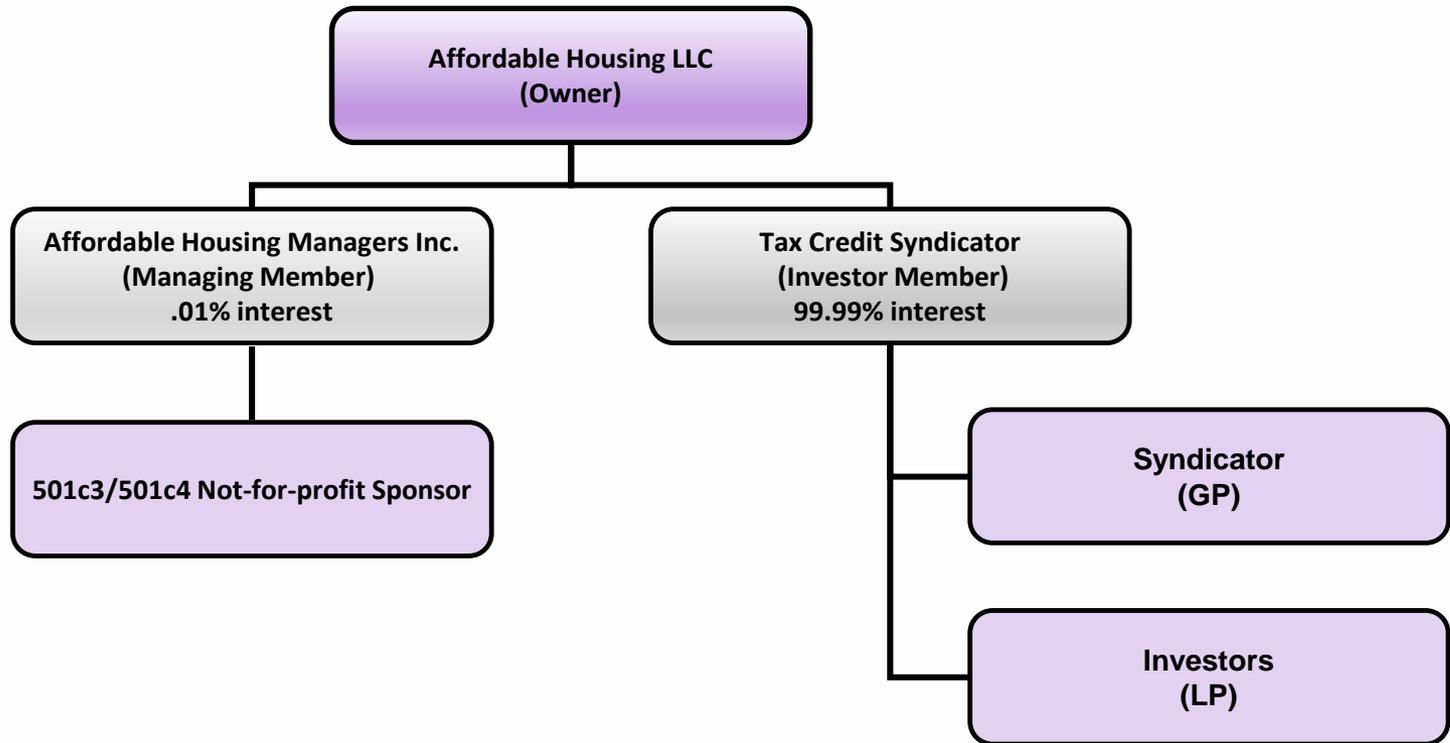
- Allowed the sale of LIHTC projects through the **right of first refusal** to certain qualified groups at a bargain price
  
- Minimum purchase price = debt + taxes
  
- Minimum purchase price is available to:
  - Tenants
  - Government agencies
  - Qualified non-profits
  - Resident management corporations



# Spotting Key Issues and Obstacles



# EXAMPLE OF A TYPICAL LIHTC LEGAL STRUCTURE





# KNOW YOUR PARTIES

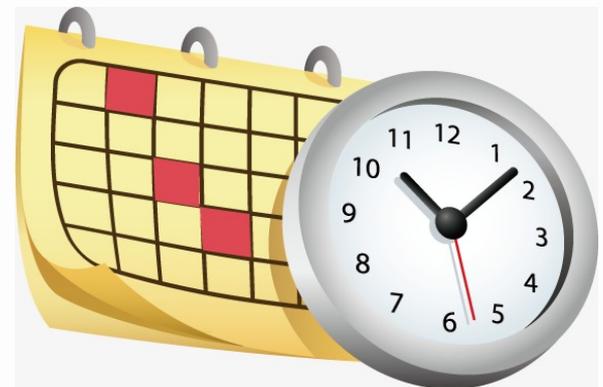
- Syndicator/Tax Credit Investor
- Joint Venture Partner, if any
- Lenders
- Regulatory Agency (Allocating Agency)





# KNOW THE TIMING WHEN YEAR 15 BEGINS

- The initial compliance period ends on the fifteenth year from the first credit period.
- Section 42(i)(1) Compliance Period – the Term “compliance period” means with respect to any building the period of 15 taxable years beginning with the first taxable year of the credit period with respect thereto
- May be different for different projects
- Plan disposition in Year 16 for the last building placed in service
- Example:
  - Tax Credits allocated in 1999
  - Building Placed in Service 7/24/2001
  - Elected to begin taking credits in 2002
  - Year 1 = 2002; Year 15 = 2016
  - Tax Credit Compliance Period expires 12/31/2016
  - Transfer ownership without recapture in 2017





# Understanding Different Exit Options



## EXIT OPTIONS

Right of First  
Refusal to  
purchase  
property

Buyout option  
to purchase  
partnership  
interest

“Puts”:  
Obligation  
to Purchase

Sale to  
related  
party

Sale to 3<sup>rd</sup>  
Party

Purchase within compliance  
period (“Early Exit”)





## RIGHT OF FIRST REFUSAL

The Limited Partnership Agreement will specify how to calculate the value of the partnership. The terms in each LPA will vary, but will contain a variation of the following options:

Right of first refusal gives a qualified sponsor the right to purchase the property before a third party can. The minimum purchase price is set by Section 42(i)(7)(A) of the Tax Code and is equal to debt plus taxes. The elements are:

- i. The minimum purchase price is debt plus taxes
- ii. Debt refers to all outstanding mortgages on the property
- iii. Taxes refers to all federal, state and local taxes attributable to the sale, which may include exit taxes





## ELIGIBLE HOLDERS OF A RIGHT OF FIRST REFUSAL

- Tenants of the project (in cooperative form or otherwise)
- Resident management corporation of such building
- Qualified not-for-profit organization (as defined in Section 42(h)(5)(c), the test for the not-for-profit set aside)
- Government agency

# PURCHASE OPTION

Buyout Option gives the general partner the right to purchase either the property of the limited partners interest, depending on the LPA.

- Typically greater of fair market value of partnership interest or unpaid benefits plus taxes
- Partnership agreement may obligate general partner to purchase the property or partnership interest following expiration of LIHTC of price or formula to determine price will be estimated up front





# Applying Legal Developments



## RECENT DEVELOPMENTS

### *Court Decision on GP/LP Exit Dispute*

- In Massachusetts, the Court decided several aspects of a Not-for-Profit's exercise of its Section 42 ROFR
- Most importantly, the Court agreed that the specific Partnership/Operating Agreement could not be isolated from Section 42's intent
- The Court focused on the specific nuances of the transaction:
  - Does there need to be a third party offer?
  - Does the third party offer have to be bona fide?
  - Does a Section 42 ROFR function as a common law right of first refusal or is it an option?
  - What are the underlying tax principles?
- **LESSON: Just because a "RIGHT OF FIRST REFUSAL" is apparently included in your partnership's agreement there is plenty to review and analyze to fully understand the extent of your rights at Year 15**



## RECENT DEVELOPMENTS

### *Cantwell-Hatch Act Proposal*

Relevant part modifying Section 42(i)(7) (wasn't adopted)

#### SEC. 303. MODIFICATION OF RIGHTS RELATING TO BUILDING PURCHASE.

(a) In General—Subparagraph (A) of section 42(i)(7) of the Internal Revenue Code of 1986 is amended—

- (1) by striking “a right of 1st refusal” and inserting “an option”, and
- (2) by striking “the property” and inserting “the property or a partnership interest relating to the property”.



# Reviewing Your Year 15 Checklist



# KNOW YOUR DOCUMENTS



## LEGAL AUDIT

- Review 8609 to determine Compliance Period
- Partnership Agreement and all Amendments
  - Purchase Option/Right of First Refusal Agreement
  - Allocation of Profit and Losses
  - Distribution of Capital Proceeds
- Regulatory Agreements/Extended Use Agreements and other Restrictions Running with the Land
- Deed
- Existing Mortgages/Notes
- Funding Disbursement Agreement, if any
- HOME Written Agreement, if any
- Title Issues, including, Outstanding Liens, Taxes and Water and Sewer Charges
- Status of Tax Abatements
- 10 Year Rule for Resyndication Projects



# KNOW YOUR DOCUMENTS



## FINANCIAL AUDIT

- Audits/Tax Returns
- Operating Budget
- Capital Accounts
- Exit Taxes
- Transfer Taxes



# KNOW YOUR DOCUMENTS



## PROPERTY AUDIT

- Appraisal
- Violations Compliance
- Green Physical Needs Assessment
- Tenant Leases/Compliance Reporting
- Commercial Tenants/Leases
- Vendor Contracts/Invoices/Debt



# QUESTIONS?





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**David A. Goldstein** has vast experience in the legal field, with expertise in affordable housing development, real estate finance, government affairs, general corporate/ business law and litigation. David has extensive experience in negotiating joint ventures, as well as structuring complex affordable housing transactions. Many of these transactions involve financing by federal, state and local agencies through the issuance of tax-exempt bonds and low-income housing tax credits. Additionally, David has represented limited equity cooperatives, HDFC co-ops, and tenant associations in litigation and general corporate issues.

Beyond his active law practice, David regularly conducts workshops on various topics, including: affordable housing finance and development, negotiating and structuring joint ventures, Year 15 legal issues for low-income housing tax credit projects, and cooperative law. He has lectured and led workshops for numerous organizations, including the Enterprise Foundation, the Supportive Housing Network of New York (SHNNY), the Corporation of Supportive Housing (CSH), the Association for Neighborhood and Housing Development (ANHD), New York State Association for Affordable Housing (NYSFAFH), the New York City Bar Association, LORMAN Education Services, a continuing legal education provider, and Urban Homesteaders Assistance Board (UHAB).



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