Affordable Housing Investors Council
Dispositions Discussion Paper

2018

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I. Introduction

The Affordable Housing Investors Council (AHIC) is a non-profit association whose members support the development of affordable housing by investing in the federal low income housing tax credit (LIHTC). We provide educational opportunities, create a forum for members to share their insights on issues facing the field, and promote the investor's perspective in this unique public/private partnership. Through these activities, as well as the creation of industry best practices, we seek to preserve and strengthen the credit as an efficient and effective tool for the development of affordable housing.

This paper is a result of the interest of AHIC members in issues related to exiting their housing credit investments. It follows several panels at AHIC meetings that explored this complex topic and highlighted the need for a more robust resource for investors, written by investors. A working group of volunteers designed this guide to **support direct and indirect investors as they engage in early and year 15 dispositions** as well as to **help acquisition staff negotiate disposition language on new deals.**

<u>The dispositions process can be quite challenging. Partners in housing credit developments may have different goals and interests in exiting, and documents may be subject to different interpretations.</u> Some developers may seek to maximize their returns, while others prioritize maintaining long-term affordability. Investors have a fiduciary responsibility to their corporations, but that responsibility can be viewed in varying ways and lead to a range of approaches to negotiating a disposition. Key considerations for all concerned should include the positive stewardship of limited public resources and a participant's reputation in a relatively small and close-knit field.

While this document is focused on how investors can plan their disposition approaches at or near Year 15, it is recommended that investors evaluate and understand these dispositions considerations when making new investments. For fund investors, this entails asking syndicators to provide an explanation of how the fund will address dispositions both at the fund and lower-tier levels and getting comfortable with that plan before the closing of a multi- or proprietary fund.

<u>The following is intended for informational and educational purposes only and is not intended to supplant individual analysis by an investor or to mandate any particular business terms. Consult your attorney to ensure compliance with all applicable laws and regulations.</u>

II. Approaching Dispositions

LIHTC dispositions can occur after the end of the 15-year compliance period or between years 11-15 (an early exit). Successfully managing and executing dispositions requires addressing a number of complex issues, including strategic decisions about how to direct resources, technical analysis of value, and negotiations with various parties. This paper highlights key topics, discusses the issues, and provides examples. **Many of the issues raised here should be addressed in negotiations during the initial creation of the partnership and memorialized in the limited partnership agreement to insure the exit is as smooth as possible.**

A. OVERVIEW

Motivations to Exit: Investor limited partners (LPs) and their developer general partners (GPs) can have the same or different goals in seeking an exit, including:

- GP/LP is looking to capitalize on value due to opportune market conditions by selling the property to a third party
- The property has historically struggled and the GP and/or LP want to exit
- GP/LP desire to preserve and sustain the property
- GP wants to re-syndicate to apply for new tax credits to rehabilitate the property
- GP wants sole ownership
- LP wants to manage workload by exiting after earning credits; no residual value anticipated
- LP has a positive capital account and wants to accelerate the loss that it will recognize upon disposition by exiting early

Regardless of the factors driving the exit, determining the appropriate strategy and process for moving forward begins with an investor creating and managing a **dispositions pipeline.**

Managing the Pipeline: While each investor will determine its policies and procedures for disposition pipeline management, it is recommended that a pipeline be populated with all investments in Year 11 and beyond. Once a pipeline is established, investors can review each investment regularly.

While some assets have material residual value and warrant significant attention, others do not. The first step in managing the disposition pipeline is to identify the high level characteristics that drive the preferred exit strategy. Table 1 illustrates the key decision points.

Table 1

Strategies for Exit			
	Investment Value	Limited Partner Objectives	Exit Process
1	**No Residual Value**		
	– High debt due and payable – Significant fees owed GP – Chronic negative cash flow – Weak market prospects – Significant capital needs – Extended use provision – Restricted by ROFR	– Avoid additional capital investment or operating support exposure – Minimize exit transaction costs	– Check internal booking model to determine if tax and accounting impacts are favorable for an early exit – Estimate property FMV – Identify all debt and GP liabilities – Negotiate exit tax obligation if applicable – Assign interest to GP
2	**Minimal Residual Value**		
	– Debt equal to or marginally less than FMV – Breakeven or marginal net cash flow – Some Reserves – Weak market with few alternate use prospects – Extended use provision	– Avoid additional capital investment or operating support exposure – Minimize exit transaction cost – Recoup all or part of deferred or unpaid asset management fees owed, where payable	– Check internal booking model to determine if tax and accounting impacts are favorable for any early – Confirm debt, reserves and any notes – Estimate property FMV – Negotiate exit tax obligation if applicable – Assign interest to GP for negotiated residual
3	**Material participation with cash proceeds < $500k**		
	– Balanced debt coverage – Net cash flow – Reserves – Proceeds are likely to exceed partnership obligations in a sales scenario – Extended use provision	– Participation in proceeds – Modestly higher legal or exit transaction costs	– Discuss with Syndicator (if applicable) exit strategy at least 12 months before end of Year 15 and accounting impacts are favorable for an early exit – Appraisal or BOV to determine FMV – Confirm debt, reserves and any notes – Perform capital liquidation analysis where – Negotiate sale value and LP distribution – Assign interest to GP for negotiated residual or negotiate a third party sale for both partnership interests – Negotiate exit tax obligation if applicable
4	**Material participation with cash proceeds > $500k**		
	– Strong cash flow – Proceeds from sale are significantly higher than partnership obligations in a sale scenario – Extended use provision	– Participation in proceeds with exits – Appropriate legal or other transaction costs encouraged to help maximize investor proceeds	– Discuss with Syndicator (if applicable) exit strategy at least 12 months before end of Year 15 – Check internal booking model to determine if tax and accounting impacts are favorable for an early – Appraisal or BOV to determine FMV – Confirm debt, reserves and any notes appropriate and negotiate sale value and LP distribution – Assign interest to GP for negotiated residual or negotiate a third party sale for both partnership interests

B. EXIT OPTIONS

Limited Partnership Agreement (LPA) Dispositions Language: The LPA usually describes provisions that pertain to exit types/strategies. The investor should start by understanding its consent rights and the exit options and obligations in the partnership agreement, any separate purchase option or right of first refusal, and any relevant amendments. Some partnership agreements require LP consent for early exits prior to year 15, while others do not require LP consent for any exits. Similarly, language can differ about the authority of the LP to compel a liquidation or for the GP to refinance debt. (Here are some typical rights/options. **(See Exhibit I.)**

- General Partner Option to Purchase the Property: this option allows the general partner to purchase the property from the partnership, after which the partnership would be dissolved. Different rules apply to for-profit and non-profit GPs.
    - **For-profit GPs** are often granted an option to purchase the property for its fair market value (FMV) or the greater of FMV or debt plus exit taxes. The FMV calculation is usually driven by an appraisal process or commissioning a broker's opinion of value (BOV), and the sales proceeds are then distributed to the partners pursuant to the terms of their partnership agreement. The FMV price is required for tax purposes, and investors should ensure that they are involved in its determination. Issues that get negotiated include who selects the appraiser (see below). Investors typically seek to limit this option to a 6-12 month period following the end of compliance.
    - **Non-profit GPs** may be granted a Right of First Refusal (ROFR) to purchase the property at the end of the compliance period. By statute, the minimum ROFR price is outstanding debt plus exit taxes; the ROFR purchase price may also be specified in the partnership agreement. In instances where this price would exceed the market value of the property if sold, the partners can negotiate a lower sales price. Similarly, this is the minimum price according to the Internal Revenue Code; investors are not precluded from pursuing a higher price. Points of negotiation include what constitutes a bona fide offer that triggers a ROFR and the treatment of partnership reserves. (See Section E. Negotiation Points.) Again, investors may seek to limit this option to a 6-12 month period following the end of compliance.

- General Partner Option to Purchase the Limited Partnership Interest: GPs often have an option to purchase the limited partner's interest at the greater of a) FMV or b) outstanding debt plus exit taxes. This option could be exercised as part of an early exit or a year 15 exit, and a sale of a partnership interest through an option can follow a liquidation process. Investors should try to have the FMV of the LP interest defined as the liquidation value of the LP interest as if the property were marketed and sold to a third party buyer. Investors typically seek to limit this option to a 6-12 month period following the end of compliance.

- Investor Put Option: this option allows the limited partner to sell its interest in the partnership to the general partner at a specified price. The put price should be a nominal amount stated in the LPA. A put option may also be negotiated to start in year 11 rather than year 16.

- Call Option: this option would allow the general partner to purchase the interest of the limited partner after year 10 and/or credit delivery is complete. In this instance, a recapture agreement would be pre-negotiated. Investors may not be comfortable with this approach because of the long term of the investment. Tax issues may arise if the purchase price is less than FMV; consult with tax counsel.

- Bargain Sale (Charitable Donation) to a Nonprofit: this option allows the limited partner to donate its interest in the partnership to a nonprofit entity for a below-market value price. Involve tax counsel early to determine if this is a viable strategy: a bargain sale must be pursued on a charitable basis, not to increase an economic return. Consider the value of the potential donation as balanced against the cost of the valuation and documentation process. Being comfortable with the valuation of the donation is crucial.

- Foreclosure: this option might be the investor's last resort as a viable strategy when the debt exceeds the value of the project later in the life of the deal.

- Abandonment. In rare instances, a limited partner may choose to abandon its interest in a lower tier partnership as a means of liquidating an investment partnership. Abandonment requires notice to all stakeholders in the underlying property. State law varies on how notice is to be given and the stakeholders to be notified.

- Qualified Contract: Depending on what commitments were made in the tax credit application and/or the Land Use Regulation Agreement (LURA), the owner can sometimes take the property out of the LIHTC program and convert it to market rate rents by going through the qualified contract process. The Housing Finance Agency (HFA) or federal regulations set a price at which the state must find a buyer. If the HFA does not secure a purchaser within one year, the extended use agreement terminates. Some HFAs impose restrictions on or prohibit the qualified contract process, reducing points on applications for housing credits unless applicants agree to forgo this option. The National Council of State Housing Agencies has called for allocating agencies to require all applicants to waive their right to submit a qualified contract as a condition of receiving an allocation.

Other Documents to Review: In addition to the limited partnership agreement, these documents can be relevant to a disposition process. It is important to understand the consent rights of other parties to the transaction, including any government funders at the federal, state, and local level and any lenders and/or bond issuers that provided financing to the development.

- Recorded LURA as well as all extended use covenants and provisions required by soft debt financing
- Hard debt loan documents and terms, including prepayment options
- Soft debt loan documents
- Any government rental assistance contracts or other restrictions
- Analytic sheet reflecting current period quarterly interim statements
- Most recent year-end audit, tax return/K-1 including tax capital account balances for all partners and tax basis depreciation/amortization detail
- Most recent annual physical inspection reports and a capital needs assessment
- Satisfactory third party broker opinion of value (BOV) and/or appraisal for assets with substantial residual opportunities.
- Form 8609 for LIHTC properties
- Park Services Part III approval form for properties with historic tax credits
- Original underwriting/investment committee memo/models
- Option/right of first refusal

C. VALUATION ANALYSIS

Accurate valuation is critical to a successful disposition, but the level of detail required and the specific issues to focus on depend on the characteristics of each deal. A rough estimate of residual value is a useful first screen to determine the appropriate strategies for an exit on the matrix in Table I above. AHIC has created an **Internal Valuation Template** (see Exhibit II) that can be used as a guide for valuation/purchase price calculation.

Valuation of Property: The value of a property depends on a number of factors, including:

- Current operations (occupancy, revenue, expenses, cash flow)
- Current condition/extent of capital needs
- Market conditions
- Regulatory restrictions – look for extended use requirements and consider whether a non-profit right of first refusal (ROFR) comes into play. Determine whether there are any other requirements associated with federal, state, or local subsidies or financing.

Most inputs related to current conditions are straightforward and easily obtainable from property financial statements. For this initial screen, use a generic cap rate for the market and review the audit for partnership liabilities/assets to determine potential residual value. Initial analysis should test a range of cap rates to establish a range of values. If the estimated value is materially in excess of partnership obligations, then further analytical work is merited.

- Obtain capital account information and tax basis depreciation/amortization detail.
- Review the debt documents for lock out dates or prepayment penalty/yield maintenance requirements.
- Determine impact of any rental subsidies on net operating income (NOI).
- Determine impact of public financing on partnership value (i.e., cashflow, reserves and consent requirements).
- Depending on the estimated amount of residual value, an investor may elect to obtain an appraisal or broker's opinion of value to determine fair market value.
- For rights of first refusal, qualified contracts or bargain sales, see also "Exit Taxes" below.
- Once fair market value is determined and partnership obligations are identified, perform a capital account/liquidation analysis.

Valuation of Partnership Interest: Absent a forced sale provision, dispositions are typically negotiated considering the FMV of the limited partner's interest on the open market. Standard methodology includes using a net asset approach to determine the value of the real estate netted with the other assets and liabilities of the partnership. To the extent that the value of a partnership is positive, an appraiser or broker can be used to determine value as discussed below. To the extent that partnership value is nominal or negative, as in some cases where there is a nonprofit ROFR and/or public debt with deferred and accrued interest, the limited partner will typically choose to assign its interest to an affiliate of the general partner.

Determining Fair Market Value: an appraisal is typically a backward-looking analysis, with valuation established from transactions that have closed, while a broker's opinion of value (BOV) is typically forward-looking, with a broker reflecting active market conditions. In a rising market, a BOV value will be higher than an appraised value. However, partnership documents may require an appraisal or a particular valuation process. Potential issues related to determining fair market value include the following.

- Engaging an Appraiser: the engagement with the appraiser dictates the way the appraiser will value a property. The language used can affect the appraiser's methodology and ultimately the final valuation. For example: a property in California may have a significantly different value to a non-profit than a for-profit due to the property tax abatement in California. An appraiser may not know which valuation is requested if the language in the engagement letter does not address this issue. Furthermore, only those parties named in an engagement letter can contact the appraiser for questions or clarifications. As a result, it is important for the LP to be involved in the engagement. **The LP should review the language to ensure it appropriately covers the assignment and insist on being a named client** (perhaps even signing the contract). This will allow the LP the opportunity to work with the appraiser and the GP in a transparent process.

  The LPA will outline the qualifications and selection of the appraiser. One common method is the three appraisal approach, under which the LP and GP both secure an appraisal. If the difference between the two appraisals is greater than 10%, then the parties jointly select a third appraiser. This third appraisal is binding if it is within the range of the initial appraisals. If it is outside of the range, then the average of all three appraisals is used for determining FMV.

  Many investors require that the appraiser have at least 5 years of LIHTC appraisal experience in the geographic area where the property is located.

- Reviewing the Appraisal: once an appraisal is complete, the investor and the syndicator, if any, should review it carefully. Even small errors or minor changes to assumptions can have a significant effect. If a named client, the LP can speak with the appraiser directly. However, even if the LP is a named client, the LPA may not address what can be done in an instance of a disputed appraisal. Given that it may be important to the valuation, the LP should be involved in the engagement and setting the direction of the appraisal. Please seek legal counsel to determine your rights.

- Other Considerations when Reviewing Value

  - Are **current rents** on this property at or below the market?
  - Is the **market** currently depressed? Would it be beneficial to wait to exit?
  - Is the GP attempting to erode the residual value of the property by proposing **capital expenditures** beyond a reasonable period or scope of work? Examine the level of repairs and, if there are concerns, request a capital needs assessment.
  - Is **refinancing** an option to "buy-out" the LPs? One drawback with this approach is that lenders will probably require approval of the exit; also, if the property has financing from HUD, the timetable may be considerably lengthened.
  - How is liquidation of **reserves** addressed? Will reserves be set aside to address immediate capital needs?
  - Are **expenses** normalized, or were there anomalies driving expenses higher?
  - Are there any **rent subsidies** generating value and is the term beyond the compliance period?
  - Do **PILOTs or tax exemptions** go away if the property is sold to a third party (another non-profit)?
  - Do **cash flows or incentive management fees** change after the end of the compliance period? This might be leverage to move forward an exit with no forced sale rights.

- Residual Proceeds Partnership Obligations**:** partnership obligations are netted out of FMV/sales price when determining residual value. Such obligations include the following.

- **Existing debt** – hard and soft loan balances, interest rates, maturity dates, prepayment penalties, etc.
- GP **operating deficit advances, accrued fees**, etc.
- **Deferred developer fee** -- be sure that the GP has made a capital contribution to pay down the fee. This is commonly agreed to in the LPA and thus should not be credited against residual value.

Waterfall and Capital Account Analysis: The final cash distributions to the partners will depend on the sale/refinance waterfall in the partnership agreement and the results of a capital account analysis. A capital account is a record of each partner's share of the partnership's economic activity. All capital accounts start at zero; they are increased by capital contributions and income allocated to each partner and decreased by distributions and losses allocated to each partner.

- Capital Proceeds Waterfall: the limited partnership agreement will define the back end splits between the partners. Generally the back end splits go 90% to the GP and 10% to the LP. Note that in syndicated funds, accrued asset management fees in the upper tier waterfall will be deducted from residual value.

- Capital Account Analysis: this is also known as a liquidation analysis. Capital account analysis will govern a partner's right to partnership assets in a liquidation of the partnership. Upon liquidation, net proceeds or residuals must be distributed to the partners in accordance with positive capital account balances. The goal of capital account allocations is to make sure that each partner has "paid for" the losses allocated and money distributed to it and to get each partner's capital account to be as close as possible back to the splits defined in the capital proceeds waterfall. In order to accomplish this, gain or loss must be calculated and allocated as dictated in the LPA. In many cases, there will not be enough loss to undo the effects of a material positive LP capital account, with the result that on liquidation, assets must be distributed differently than the percentages set forth in the capital proceeds waterfall. Capital account analysis should be used for third party sales as well as assignments of interest for value. (See Exhibit II, Capital Account/Liquidation Spreadsheet.)

  The capital account waterfall remains applicable regardless of the capital account balances. If the investor's capital account at the time of sale is negative, any gain to be allocated will be taken into consideration first as needed to restore capital account balances to at least zero. If the investor's capital account is positive, the limited partner should review the forced sale/exit language in the LPA. If the exit language is strong, the limited partner has room to negotiate between the capital account versus capital proceeds. If the exit language is weak, this may be more difficult. Some developers may claim that distributions should be governed by the capital proceeds waterfall and seek to ignore the capital account analysis. This could potentially create a tax problem for the investor as the IRS may seek to disallow the earlier allocations of credits and losses; consult your attorney for guidance.

Tax Situations on Exits

- Exit Tax Analysis: exit taxes occur when a partner's losses exceed its capital contribution. This results in a negative capital account at the sale. A negative capital account will give rise to taxable gain in an amount equal to the negative capital account. The taxes on that gain are referred to as "exit taxes." Some partnership agreements require the general partner to pay the limited partner's exit taxes. This may be subject to negotiations.

- Tax Loss on Disposition: if a partner's capital account exceeds the amount of money that it receives in a liquidation of the partnership (or in connection with the sale of its interest), the partner will recognize a loss. Sometimes a partner will want to move up its exit in order to accelerate the timing of its ability to claim this loss.

- Transfer Taxes: states, counties, and cities may impose transfer taxes upon a transfer of property or a sale of the partnership interest. Partnership agreements should state which partner has the obligation to pay the transfer taxes.

D. EARLY EXITS

LIHTC dispositions prior to the end of the 15-year compliance period are becoming increasingly common. Early exits are typically pursued in years 11-14, after the investor has received all credits. (If you are exiting a property that has stub year credits in the year you are exiting, you must exit after December 16 in order to claim all of that year's credits.)

While they can be beneficial to all parties involved (GP, syndicator, investor), early exits can also create risks and require additional analyses beyond the standard year 15 disposition analysis.

	Benefits	Risks
GP	• Accelerated "free and clear" ownership of property without LPs • Market timing to maximize value • For non-profit GP, waiting till Yr. 15 might produce exit taxes	• Additional compliance guarantees or recapture bond fees required by LPs
Syndicator	• Accelerated receipt of residuals and thus payment of accrued fees • Market timing to maximize value	• Limited reporting and oversight of remaining compliance period
Limited Partner	• Accelerated receipt of residuals OR capital write off in the case of loss. • Market timing to maximize value • Eliminate audit and tax expenses • Eliminate asset management of property	• Compliance/recapture risk through Year 15 • Valuation of future benefits/market movement

Valuation Analysis: evaluating an early exit proposal requires creating **two valuation analyses**, one valuing the property under current conditions with an early exit and one projecting the value after the end of the compliance period. In addition to the valuation issues discussed above with respect to typical dispositions, early exit valuations should consider:

- Loan prepayment penalties
- Payable deferred development fees and
- Exit and transfer taxes, to determine any differences from exit taxes.

Projections of future exit value should include:

- Future market value using defensible underwriting assumptions
- Debt amortization and
- Amortized capital accounts.

GAAP Issues: early exits may create GAAP issues for investors utilizing the equity method of accounting. If a general partner is requesting an early exit in a fund that has 15 year credits, this early exit may accelerate losses in future years into the current year even if the specific property being exited does not have 15 year credits. This might cause volatility in the losses in the year of the early exit. Early exits rarely occur where credits are still flowing to the LP.

Unpaid Deferred Developer Fees: if exiting a partnership early and the partnership still has a deferred development fee payable on its books, the limited partner should get the fee paid down as quickly as possible. The general partner must make a capital contribution to pay off the outstanding balance or take the fee into income before the early exit. The risk is that the credits associated with the basis-included developer fee could be revised and recaptured.

Indemnities/Ongoing Compliance: the biggest risk to investors associated with an early exit is that credits remain subject to recapture if a compliance violation occurs before the end of year 15. To avoid recapture on an early sale or LP transfer, there must be a reasonable expectation that the property will remain in compliance through the end of year 15. This reasonable expectation is met in the underlying documents evidencing the transfer or sale. Investors should properly quantify the magnitude of the potential recapture exposure before agreeing to an early exit or specific exit provisions. Although the likelihood of recapture is small in most cases, the maximum exposure could be quite large. Recapture exposure decreases with each passing year of compliance. Investors may have different risk tolerances for degrees of uncovered recapture risk, but the magnitude of this risk should be weighed against early exit benefits. Once an investor no longer owns the property, there is limited access to compliance information and limited available remedies if there is a problem. Typically, compliance risk is addressed in one of two ways:

- General Partner Guarantee: the GP provides a guarantee, replacing any recapture guarantee that may be associated with the LIHTC partnership that indemnifies the investor against any credit loss due to recapture. The guarantee specifies terms including scope, reporting, and maximum obligation. A guarantee is a relatively simple and direct way to address the recapture risk, but it is subject to the creditworthiness and good faith of the guarantor. As with any guarantee, the financial capacity and trustworthiness of the guarantor is crucial to the value of the legal protection. In general, the guarantor should demonstrate financial capacity in excess of the maximum recapture exposure that the investor is assuming with the early exit. Net worth and liquidity covenants may be appropriate. (See AHIC's Underwriting Guidelines, available on www.ahic.org under Tools and Resources, for a fuller discussion of guarantors.)

- Recapture Bond: although no longer required by law, recapture bonds are available in lieu of a guarantee. A recapture bond would compensate an investor in the event of credit recapture and does not rely on a guarantor. The GP requesting the early exit would typically pay the bond fee, and currently these bonds are inexpensive. A recapture bond may be preferable to a guarantee if the guarantor is not creditworthy or if the GP contemplates selling the property to a third party. The bond term should match the years remaining until the end of the 15-year compliance period. In addition to a bond, limited partners may have the buyer execute a post-transfer compliance and indemnity agreement.

- Other Collateral: depending on the circumstances, an investor may seek additional collateral, including a line of credit, cash pledges, and/or guarantees from the purchaser of the property.

Investors should follow their institutions' **Know Your Customer and Anti-Money Laundering** policies as they do when originally underwriting a transaction.

<u>Reporting Requirements:</u> early exit documents should require the GP to provide a minimal level of reporting to the syndicator/investor after it has exited to document ongoing LIHTC compliance, including the following.

- Notification of any 8823s, IRS audit, or other compliance-related action, and delivery of relevant related correspondence and resolution
- Notification of any loan default
- Notification of any legal action
- Copies of any state annual compliance certification
- Copies of any state inspection

If the early exit documents allow a future sale or transfer of GP interests to a third party, they should specify that these reporting requirements apply to the subsequent property owner as well. Investors may want to **include language that provides consent rights on GP transfer to another party, a future sale of the property, or a change in management agent.**

E. NEGOTIATION POINTS

As with any complex transaction involving two parties, there can be a discrepancy between the interests of the general partner and the limited partner and their approach to the exit and its terms. This table lays out some <u>potential areas of negotiation and possible conflicting viewpoints</u> of the respective partners. **Not all items will pertain to all exits, and different partners will have different priorities and concerns - both in general and from deal to deal depending on the circumstances.**

Negotiation Point	GP Position	LP Position
Follow the partnership agreement or exit outside of its terms?	GP may feel it was promised exit terms that were more favorable than the partnership agreement.	Disposition should match LPA provisions. The transaction was closed between sophisticated parties represented by counsel.
GP paying tax equivalency payment to compensate LP for gain recognized on exit	LP already received benefit of losses claimed. A tax equivalency payment resulting from the LP's gain on exit (i.e., a negative capital account) allows the limited partner to claim the benefit and then get paid for it.	The partners should follow the terms in the partnership agreement.
Replacement reserves	GP may affirm that as part of the dispositions analysis, partners should determine the cash needs for the project to be sustainable through the extended use period. If there are remaining cash proceeds after taking these needs into account, those are up for negotiation between GP and LP. The National Council of State Housing Agencies (NCSHA) recommends states require that reserves remain with the development.	The replacement reserve is a partnership asset and should be included when completing the capital account analysis. Immediate cash needs can be an appropriate use. GP spending or releasing of reserves prior to Year 16 should be reviewed for reasonableness. Lenders might also have an interest in replacement reserves.

Operating reserves	Some GPs may take the position that the reserves should be released through the waterfall prior to liquidation or transfer. Non-profit GPs might argue that reserves should stay with the property after executing ROFR and should have no value assigned to them. NCSHA recommends states require that reserves remain with the development.	The operating reserve is a partnership asset and should be included when completing the capital account analysis.
Unpaid asset management fees	The property did not produce cash and the fees are not guaranteed.	The partnership has cash assets in the form of reserves funded by the LP at closing. These funds should pay partnership obligations.
Require bona fide offer to trigger ROFR	Requiring a bona fide third party offer, when the formula price is already established in the partnership agreement, is an unnecessary administrative burden that only delays a disposition. Federal legislation has been introduced to replace the ROFR with a purchase option.	Depending on the circumstances, some investors may assert that a bona fide offer is a necessary element of a right of first refusal.
Forced sale	GP may wish to continue operating the property, but may not have the ability to pay exiting LP the value it would achieve if the property were sold.	LP is entitled to the market value of its interest. In the situation where there is no forced sale provision and the GP is not responsive, the investor who wishes to exit may have leverage if GP wants to refinance debt on materially different terms with investor consent and/or incentive management fees change, as noted above in Determining Fair Market Value.
Payment of state and local transfer taxes	Partners should pay according to their interests.	While state laws may vary, transfer taxes are generally the responsibility of the seller in a third party sale. If the LP is selling its interest to the GP, the LP can negotiate that the GP pays the taxes.

Exhibit IV is a Sample Dispositions Memo that captures an investor's analysis of an exit in an early exit situation where there is residual value and provides one approach for an internal review. It reflects the issues discussed throughout this paper and can serve as a template that distills the steps outlined above.

III. Exhibits

Exhibit I: Exit Options

LP is retricted by a ROFR

Use this model when there is a ROFR limiting what the LP can receive when exiting a deal to debt plus taxes.

Hard Debt Outstanding	$	1,100,000.00
Soft Debt Outstanding	$	600,000.00
Partner Notes Outstanding	$	300,000.00
Transaction Costs	$	2,500.00
Transfer Tax	$	2,500.00
Exit Taxes	$	50,000.00
TOTAL ROFR PRICE	*$*	*2,055,000.00*
Cash Distribution Waterfall		
Operating Reserve	$	100,000.00
Replacement Reserve	$	300,000.00
Other Reserve	$	25,000.00
TOTAL UNRESTRICTED CASH ASSETS	*$*	*425,000.00*
Percent Share of Cash Waterfall		10%
PROCEEDS FROM CASH WATERFALL	*$*	*42,500.00*
TOTAL CASH PROCEEDS TO LP	**$**	**97,500.00**

• The ROFR price is usually a combination of debt outstanding and taxes. In most cases the LP will receive reimbursement for transaction costs, exit taxes, and possibly local transfer taxes.
• Cash on the books consisting of unrestricted cash, operating and replacement reserves are assets that need to be separately addressed in an exit from the partnership, not included in the ROFR.
*The above example illustrates a 4% deal where the LP has no capital account or instances where the LP has a minimal capital account. For cases where the LP has a large capital account, the liquidating waterfall should be utilized for cash/reserves to be distributed among the partners.

Qualified Contract

Applicable Where State Identifies a Qualified NFP Buyer Pursuant to GP Request to "Opt Out" in Year 14 at "Qualified Contract Price"

DEBT		
Hard Debt	$	1,100,000.00
Soft Debt	$	100,000.00
Partner Notes	$	50,000.00
Accrued Interest	$	35,000.00
TOTAL	$	1,285,000.00
ADJUSTED INVESTOR EQUITY		
Base Calendar Year *		2010
Lower of 5% or Average CPI for 12 month period ending in August of current year		4%
Lower of 5% or average CPI for 12 month period ending in August of BCY		3%
Cost Of Living Adjustment		133.3%
Equity Amount used in Development's Final Cost Cert	$	15,000,000.00
TOTAL ADJUSTED INVESTOR EQUITY	$	20,000,000.00
OTHER CONTRIBUTIONS		
Other Capital Contributions not listed **	$	-
CASH DISTRIBUTIONS		
Sum of all Cash Distributions***	$	375,000.00
DISTRIBUTABLE CASH		
Replacement Reserves	$	400,000.00
Operating Reserves	$	30,000.00
Other Reserves	$	175,000.00
TOTAL	$	605,000.00
NON CASH DISTRIBUTIONS		
Total Non Cash Distributions ****	$	-
ASSET REDUCTION		
Cash Distributed OR Available To Be	$	980,000.00
FMV		
Appraised FMV of non-affordable portion	$	-
Applicable Fraction		100%
QUALIFIED CONTRACT PRICE	**$**	**20,305,000.00**

*Base Calendar Year is the year in which the credit period ended (Year 10).

**Other capital contributions are not limited to cash and, therefore, include "in-kind" contributions such as land.
***All cash distributions include all cash payments and distributions from net operating income included, but not be limited to, (i) amounts paid to partners or affiliates as fees and (ii) amounts distributed to partners as a return of capital or otherwise. These are treated as offsets to the QC Price

****Non Cash distributions are very rare and unlikely. Take FMV of non cash distribution.

• A Qualified Contract is a bona fide contract to acquire a LIHTC project for the sum of the existing debt, adjusted investor equity and other capital contributions, less project cash distributions. The "QC Price" will establish the minimum price which is required by Section 42 of the IRC. Under the QC process, the allocating agency must procure a qualified buyer to purchase the project at the QC Price within one year. If the agency fails to do so, it must release the project from the requirements of the LIHTC program subject to the three-year deregulation period required by IRC after which, the project becomes a market rate property unencumbered by the Extended Use Agreement. Cash on the books is a seperate partnership asset that would not be part of a sale to a purchaser similar to other routine transactions.

Bargain Sale

The Partnership will donate the underlying asset to a Qualified Charitable Organization

Hard Debt	$	1,000,000.00
Soft Debt	$	100,000.00
Current Payables	$	44,567.00
Partner Notes	$	25,000.00
Deferred Fees	$	25,000.00
TOTAL DEBT	$	1,194,567.00
FMV of Asset	$	5,000,000.00
Adjusted Basis	$	1,800,000.00
Debt to FMV Ratio		24%
Capital Gain on Delta	$	430,044.12
Capital Gains Rate		21%
TOTAL CAPITAL GAINS	$	160,549.80
Tax Rate		21%
CHARITABLE DEDUCTION ON EQUITY	$	799,140.93
Net Benefit	$	638,591.13
LP Percentage		99.98%
CHARITABLE CONTRIBUTION	**$**	**638,463.41**

• This method is applicable to certain situations where the debt to value ratio is not extremely high and the property has some Fair Market Value. The method is designed to discourage transferring highly leveraged assets to charities.
*Low value charitable contributions are generally not pursued as benefit doesn't outweigh higher audit risk.

Exhibit II: Income Valuation

Property, LP - Income Valuation				
		20xx Actual	**20xx Actual**	**20xx Projected**
Rental Revenue	2%			
Less Vacancy	7%			
Other Income	2%			
Effective Gross Income		-	-	-
Management	0%			
Real Estate Taxes	3%			
Property Insurance	3%			
Utilities	3%			
Operating	3%			
Marketing	3%			
Payroll	3%			
Administrative	3%			
Bad Debt	3%			
Misc Taxes & Ins	3%			
Total Expenses		-	-	-
NOI		-	-	-
Capital Reserve (assuming $250/unit				
Cash Flow Before Debt Service		-	-	-
Hard Debt Service				
Cash Flow After Hard Debt Service		-	-	-
Non-Operating Expenses				-
Remaining Cash Flow		-	-	-
DSCR (Hard Debt)		x.xx	x.xx	x.xx
Cap Rate				
Value at end of 20xx				
Value at end of 20xx				
Value at end of 20xx				
Total Debt at YE 20xx (Includes Soft)				
20xx Projected Proforma Adjusted for 2% Revenue and 3% Expense Growth				

Exhibit III: Capital Account/Liquidation Spreadsheet

Partnership Name
Disposition, Liquidation, Capital Account Analysis - 20xx Audit/Tax

20xx Net Operating Income			+	
Cap Rate			+	
Projected Sales Price		3,500,000		
Broker Fee	4.00%	(140,000)		
GP Fee	8.00%	(280,000)		
Incentive Management Fee		0	-	
Title and Closing		0	-	
Sales Proceeds		3,080,000		
Capital Improvement Deduction		0	-	
Proceeds from Sale		3,080,000		
Debt		(700,000)	-	
Prepayment Penalty		0	-	
Net Sales Proceeds		2,380,000		
Net Liquid Assets		138,500		
Cash Available for Distribution		2,518,500		
Assets				
Cash		50,000	+	*Liquid*
Accounts Receivable		9,000	+	
Prepaid Expenses		5,700	+	
Net Intangibles		20,000	+	
Tenant Security Deposits		5,800	+	*Liquid*
Replacement Reserve		45,000	+	*Liquid*
Tax & Insurance Escrow		26,000	+	*Liquid*
Other Reserves		50,000	+	*Liquid*
		211,500		
Liabilities				
Accounts Payable/Accrued Exp		(22,500)	-	*Liquid*
Fees Payable			-	
Accrued Interest - 1st		(10,000)	-	*Liquid*
Current Debt Maturities - 1st			-	*Liquid*
Due to Related Parties			-	
Accrued Interest			-	
Tenant Security Deposits		(5,800)	-	*Liquid*
		(38,300)		

Waterfall - Net Sales Proceeds		Fund	GP
Reserves for Contingent Liabilities		0	0
Repayment of Voluntary Loans		0	0
Administrative/AM Fees Payable		0	0
Repayment of Deferred Developer Fee		0	0
ILP Return of Capital		0	0
GP Return of Capital		0	0
ILP Portion	10.00%	251,850	0
GP Portion	90.00%	0	2,266,650
		251,850	2,266,650

Gain Calculation

Net Sale Price	3,080,000	
Prepayment Penalty	0	
Balance Sheet Liquidation	(14,700)	
Building and Improvements	2,100,000	+
Land	90,000	+
Accumulated Depreciation	(683,050)	-
Fee Write Off	40,000	+
	1,546,950	
Allocable Gain	1,518,350	

Gain Allocation	LP		GP		Partnership
	10.00%		90.00%		
Beginning Capital Account	1,000,000		150		1,000,150
Distributions YTD	0	-	0	-	0
Income YTD	0	+	0	+	0
Adjusted Capital Account	1,000,000		150		1,000,150
Allocation of Gain - Zero Capital Account	0		0		0
Allocation of Loss from Sale	0		0		0
Allocation of Gain from Sale	0		1,518,350		1,518,350
Dissolution Capital Account	1,000,000		1,518,500		2,518,500

Lower Tier Distributions

Repayment of Voluntary Loans	0	0	
Administrative/AM/Developer Fees	0	0	
Positive Capital Account	1,000,000	1,518,500	2,518,500
Book/Tax Difference Adjustment	0	0	
	1,000,000	1,518,500	2,518,500

Exhibit IV: Sample Dispositions Memo

Cover Letter:

Partnership:	State Street Apartments
Fund:	Windy City I (Fund I)
Current Date	1/29/2016
Key Dates:	Syndicator request review and approval by x date
Early Exit: Yes/No	Yes
Contact Information	Bertha Palmer 312-222-2222

Recommendation Paragraph

Sample Narrative: Fund I is the Investment Limited Partner in State Street Apartments (the "Project"). The Project's General Partner is Marshall Field.

The General Partner has offered to purchase Fund I's Investment Limited Partner interest for $2.0MM. The Project's initial 15-year compliance period expires on December 31, 2016. The Buyer will provide a full tax credit guarantee. The General Partner will pay cash and is ready to close immediately.

Syndicator recommends accepting the proposed purchase offer for the Investment Limited Partner interest as the sales price is deemed to be reasonable and fair. The recapture exposure is mitigated by the tax credit guarantee to be provided through the duration of compliance. For the following reasons we recommend you take this action:

- The LT GP proposal represents a substantial improvement from the original July 2014 purchase offer where substantial yield maintenance, as a deduction to the property valuation, provided no residual value to the upper tier investor.
- Low cap rates and significant demand in the market suggest now is the best time to capitalize on this residual.
- Low execution risk: The transaction is projected to close on January 31, 2016. Chicago Holdings, LLC (parent entity of State Street Apartments) has internal resources sufficient to fund the purchase price and the transaction is not dependent on a refinance in order to close.

Background:

- Description of the property (units, location, new construction, # of bedrooms)
- A summary of property operations, the market and physical condition of the asset. This would include a summary of the market, the neighborhood, and any other economic factors having an impact on value, as well as whether any capital expenditures are needed. This should also include background on any debt, including prepayment penalties, interest rates, etc. Any reserves at the property should also be mentioned, including any restrictions on these reserves. Finally, lower tier sponsorship should be discussed (for-profit or non-profit status, as well as whether there are any concerns about ongoing oversight of an early exit).

Sample narrative: The Property is a 400-unit family complex located in Chicago, IL. The Property was a new construction development that placed in service in 2001. The Property contains 200 two-bedroom units, 100 three-bedroom units, and 100 four-bedroom units in 15 residential buildings. All units are restricted at 60% AMI. The property was found to be in excellent condition during the last inspection in 2015 with no major capital expenditure needed.

The Property's first mortgage is held by Fannie Mae and bears an interest rate at 8.00% and matures on January 1, 2018. A prepayment penalty exists through June 2017. The Property's second mortgage is held by IHDA and bears an interest rate at 3% or 6%, depending on the Property's cash flow, and matures on May 1, 2021. Reserves are fully funded with a replacement reserve balance of $600K. There is an operating reserve of $300K, which is required to be distributed upon exit.

Property Operations: Summary of operations for the past few years including occupancy, DSC ratio, cash flow, etc.

Regulatory Restrictions: What are the extended use provisions? Is there a ROFR in the LURA? Any additional requirements including HOME, etc.?

Key Partnership Provisions: Description of GP Options, ROFR, Put Options, Call Options.

Valuation Analysis Lower Tier and Upper Tier:

- Broker's Opinion of Value, Appraisal, Hard debt/Soft debt; ground leases, if applicable. Preliminary valuation based on audited numbers and appropriate cap rate. A Broker's Opinion of Value needs to be commissioned when there is significant value.
- Tax effects, exit taxes, gains, losses and income related to debt forgiveness.
- The liquidation waterfall should be used at the LT as well as the UT for a single asset fund or the last property exited in a multi-asset fund. The liquidation waterfall only needs to be performed when there is residual value and a material LP capital account that may affect residual splits. The sales/cash and refinancing waterfall at the UT would be referenced when you still have more assets left to liquidate in the Fund.
- For early exits, a forecast of residual value, should we decide to exit at the end of the compliance period. This should account for prepayment penalties and amortization of debt year over year.
- If there is no residual value given significant debt obligations or a ROFR for debt plus taxes with a qualified non-profit, then Lower Tier and Upper Tier valuation is not applicable. In those cases where there is a valid ROFR, but the asset is highly appreciated, we do need to include analysis of settling up of cash and reserves which are separate from the physical asset.

Sample narrative:

Lower Tier Analysis of Sale Proceeds

The Brokers Opinion of Value provided by a qualified LIHTC experienced broker to be approved by the ILP, estimated the gross sales price for the property to be $10M based on a cap rate of 7.5%. Although the Managing Member received an appraisal for a slightly lower amount, he has agreed to use the $10M valuation resulting in approximately $2.5M available to distribute through the cash waterfall. We analyzed the residual value based on current numbers and compared them to originally projected numbers and determined there was no priority distribution under section 11.05(h) of the LPA. Our analysis was prepared under the assumption that the sale of the Investor Member's interest would be treated as a liquidation of the partnership. The gain associated with this transaction was allocated to the Managing Member for purposes of determining the liquidation distributions based on the capital account balances. As a result, the Investor Member at the UT would receive $2.0MM.

Upper Tier Waterfall and Analysis of Sale Proceeds
The First Amendment to the Amended and Restated Agreement of Fund I ("Fund Agreement"), dated November 1, 2002, contains a definition for the Distribution of Sale or Refinancing Proceeds in Section 4.2, noted as follows:

- First, to each Limited Partner in the amount of its Adjusted Capital Contribution;
- Second, to the General Partner in an amount equal to its Adjusted Capital Contribution;
- Third, the balance among the Partners in accordance with their respective Interests.

Please note that "Sale or Refinancing Proceeds" is defined in the Fund Agreement as the total amount of cash received by the Fund through a sale or refinance, less expenses incurred related to such sale or refinance, and also less any accrued but unpaid Asset Management Fees.

Again, the above references a sales/refinance waterfall, but the liquidation waterfall should be used when 1) disposition of the lower tier asset would necessitate liquidation of the upper tier (single asset fund), or (2) disposition of the final asset of a multi-asset fund necessitates liquidation of the upper tier.

Based on the Fund I balance sheet on 1/1/16, the following waterfall presents an estimated use of proceeds, including investor distributions:

Purchase Price	$	2,500,000
Accrued AM Fees Payable - 1/1/16	$	500,000
	$	500,000
Remaining distributable cash	$	2,000,000
Limited Partner - 99.99%	$	1,999,800
Syndicator as ILP and GP - .01%	$	200

* To be updated for mortgage balance on day of closing, or as close as is practical

Ongoing Compliance Reporting/Guaranty information (Early Exits Only):

- Guaranties? Recapture Bonds? Exposure going forward? Current requirements and future requirements outlined if 3rd party sale or assignment is to a new GP.

Sample narrative:

Early Exit Analysis
The Property's initial 15-year compliance period expires 12/31/2016. The following table estimates the maximum recapture and interest penalties that would be applied if all tax credit units in all 13 buildings were to become permanently noncompliant during the following years:

Year	Credits	Interest	Total
2016	$ 1,079,412	$ 288,979	$ 1,368,391

Guarantee and Buyer Due Diligence
The Operating Partnership's GP entity rolls up to Macy's holdings, which will guarantee tax credit compliance after the sale. All existing guarantees currently in place covering compliance through the transfer of the ILP interest will remain in place. Updated financial statements will be collected and reviewed prior to closing to ensure the Guarantor's financial position has not materially deteriorated in the last 18 months.

Attachments
1. Capital Account Analysis (if applicable)