

Year-15: Roadblocks and Solutions



*A conversation on Year-15
Disputes*

The Problem



CED Capital Holdings 2000 EB, LLC v. CTCW Berkshire Club, L.L.C.
2020 WL 6537072 (Fla.Cir.Ct. Nov. 3, 2020):

- *“a trend in the LIHTC industry in which certain entities, like Hunt, are acquiring limited partner interests in LIHTC partnerships – known as **“Aggregators”** – who then attempt to extract value out of such interests that were not intended by the original parties to the partnerships.”*
- *the **“Aggregator’s playbook”** is designed to disrupt year-15 exits “to drive a cash return . . . that was never intended by the original tax credit investor or anyone originally involved in the Project.”*

The Problem



JER Hudson GP XXI LLC v. DLE Invs., LP, 275 A.3d 755 (Del. Ch. May 2, 2022):

- “Recently, *a new type of buyer has emerged* to buy the investors’ discounted limited partnership interests. It purchases a limited partnership stake from the initial investor after the investor harvested the property’s tax credits. As a new limited partner, *the buyer engages in a now-nationally-familiar pattern of tactics* to prevent the property from being transferred to the nonprofit.”

The Problem



CED Capital Holdings X LTD v. CTCW Waterford East, L.L.C., 2023 WL 3436906 (Fla.Cir.Ct. May 8, 2023)

- The Aggregator “***trend has intensified***” over the last few years as more and more courts and tribunals across the country continue to address Year-15 exit disputes.
- Citing a March 2023 Federal Court decision that released records from confidential court filings because the **public’s particular interest in Year-15 issues “has been well-documented.”**

Aggregators: who are they?



- Often bill themselves as “affordable housing **asset management firms**”
 - They **aggregate investor/syndicator interests** in LIHTC partnerships/tax credit funds.
 - Their **ownership/role is often not apparent** and found in the “upper tier” partnerships.
 - **Treat the partnership and their stake in it as an economic interest**—*i.e.*, an investment in real estate and related cash flows, rather than an investment in tax credits
 - **Seek to extract maximum cash** at the expense of the program and low-income persons.
 - Utilize **burdensome tactics** to whittle down and outlast opponents.



Aggregators: who are they?

- The “Aggregator’s Playbook” has begun to spread:
 - The growing list of firms making use of the Aggregator’s playbook also includes “[s]ome...[who] are taking advantage of the investor interests they already hold in LIHTC projects....”
 - *Nonprofit Transfer Disputes in the Low Income Housing Tax Credit Program: An Emerging Threat to Affordable Housing*, Washington State Housing Finance Commission, at 1 (September 2019)

The Roadblocks: where they lurk



- Section 42(i)(7) ROFRs
- Purchase Options and Option Prices
- Fair Market Value / Appraisals / Broker's Opinion of Value
- Capital Accounts / Liquidation
- Refinancing
- Qualified Contract / Forced Sale Provisions
- Limited Partner Removal Initiatives

The Roadblocks: the OLCDC case



- *Opa-Locka Community Development Corp., Inc. v. HK Aswan, LLC, 2020 WL 4381624 (Fla.Cir.Ct. July 7, 2020), aff'd sub nom., 2021 WL 4190914 (Fla. 3d DCA Sept. 15, 2021)*
 - **“After the end of the Compliance Period, [Owner] will not sell the Project ... to any Person without first offering the Project for a period of forty-five (45) days to Purchaser”**
 - **Argued common law, “enforceable offer” requirement should be imposed onto this Section 42 ROFR:** an accepted Letter of Intent, conditioned on waiver of ROFR rights, was allegedly not sufficient

The Roadblocks: the Pathway case



- *SunAmerica Hous. Fund 1050 v. Pathway of Pontiac, Inc.*, 33 F.4th 872 (6th Cir. 2022)
 - **“Upon receipt of a bona fide offer, Partnership shall notify [nonprofit] in writing of the offer, and [nonprofit] shall thereupon exercise its right of first refusal within thirty (30) days. . . .”**
 - **Rejected consent of limited partner required to trigger ROFR: ROFR exception**
 - **Argued common law meaning of “bona fide offer” should be imposed: again rejected “enforceable” requirement and could be solicited to exercise ROFR.**
 - **Refused to require a “genuine” intent to sell to the third party offereor.**

The Roadblocks: the ROFR Price



- *AMTAX Holdings 227, LLC v. Tenants' Development II Corp.*, 15 F.4th 551 (1st Cir. 2021) :
 - Section 42(i)(7) does **not** specify how the contractual mechanism must operate, **only**:
 - **Who** may hold and exercise the ROFR—a qualified nonprofit, tenants/tenant group, governmental agency;
 - **When** the ROFR may be exercised—after the end of the Compliance Period; and
 - **The minimum price.**

The Minimum Price



- the principal amount of outstanding indebtedness secured by the building (other than indebtedness incurred within the 5-year period ending on the date of the sale to the tenants); and
- all Federal, State, and local taxes attributable to such sale.

The Debt-Plus-Taxes Price.

The Roadblocks: Options



➤ Disputing Purchase Options and Option Prices

- Demanding that positive capital accounts be returned as cash through an Option Purchase Price, arguing that Section 704(b) requires such treatment.
- Demanding that valuations assume Partnership dissolution and asset liquidation rather than going concern valuation.
- Demanding that Options to purchase LP Interests in a Partnership be treated the same as Options to purchase the Property.

The Roadblocks: the St. Mary's, Hopkins Court, and Villagebrook cases



- A Property sale and a Partnership dissolution are **two separate and distinct events**.
- While a sale triggers a dissolution and **thereafter** a Partnership liquidation, this **does not mean** the sale and its proceeds are automatically included in the subsequent liquidation.
- Sale / Capital Transaction Waterfalls are **first used** to distribute proceeds **before** applying Liquidation Waterfalls to distribute any remaining funds based on capital accounts.
- *The fact that a sale waterfall is made “[s]ubject to the provisions of” a liquidation waterfall simply means that the project could be sold during the dissolution process and provides in that event for the distribution of the proceeds pursuant to section 12.4 (A).*
- **Rejected arguments** that a distribution of sale proceeds in in this manner violates the tax code.

The Roadblocks: the Berkshire and Waterford cases



- **Berkshire:** Florida court rejected same arguments where Partnership Agreement specifically required the **Option Purchase Price for LP interests be calculated based on hypothetical sale under Sale Proceeds Waterfall.**
- **Waterford:** Florida court reached same conclusion as in Berkshire where Option was to purchase property, not LP interests.
- The exercise of the Options and the transactions contemplated by them **did not involve a direct liquidation or dissolution of the Partnership**, thus there is no need to consider capital account balances to determine the Option Purchase Price.

The Roadblocks: the White Settlement case



- GP granted the **right to purchase the Interests of the Limited Partners** for the “fair market value of the Limited Partner’s Interest”
- As confirmed by a Texas district court and appellate court, the arbitrator concluded that the purchase price for the LP interest was to be “**determined based on a going concern valuation . . . assuming continued use of the property** owned by the Partnership (the “Property”) for low-income housing.”
- “[E]ven if the Limited Partner could force a sale of the Property, it still cannot reasonably expect to benefit from a sale because, in part, Claimant’s Option plainly confirms that a going concern valuation shall be utilized to determine the Option Price regardless of any supposed sale of the Property.”

The Solution: Housing Agencies Act



- WSHFC, Tax Credit Compliance Procedures Manual, Ch. 9 Property Transfers, at 3-4 (Dec. 2019), (“Commission will consent to a proposed Property Transfer...only if it is determined that:...For [a] limited partner...the Transferee has not had a claim filed against it in litigation in any jurisdiction concerning a sponsor’s, partner’s, or member’s ownership interest in a project after the initial term of the partnership (year-15 exit)”).
- *Notice of Funding Availability: March/April 2021*, Massachusetts Department of Housing and Community Development, (providing that to obtain a Housing Credit allocation, the “investor cannot have been involved in any ‘aggregator’ activity, in Massachusetts or in other states, seeking to undermine the exercise of a LIHTC [ROFR]/right of first option, including, without limitation:...[via a] Lawsuit”)

The Solution: be educated and plan ahead



- **Be educated** on the issues that Aggregators target (though this has proven to be an ever-moving target).
- Take steps to **address Year 15 issues at the front end** of new deals where possible:
 - Begin addressing Year 15 issues early, including in letters of intent, to **weed out investors and syndicators likely to instigate Year 15 exit disputes** (then include a requirement that consent must be given to all transfers of LP interests)
 - **Make agreements as specific as possible**
 - **Reject inclusion of problematic conditions/terms** that are not required by Section 42

The Solution: be educated



- Be able to **identify when you might be dealing with an Aggregator** on the backend.
- The **names aren't always the same** and new firms continue to emerge, but the tactics and associated **red flags remain largely the same**.

10 Red Flags in LIHTC Deals

1. Investor limited partner interests have changed hands from original investor limited partner. Is your partner today the same as the one you did your deal with at the beginning?
2. The investor limited partner interests are managed by and/or affiliated with organizations (e.g., asset management firm) that have been involved in litigation concerning LIHTC project partnerships around year-15.
3. The investor limited partner has a large positive capital account and believes that it should be allowed to monetize that book entry through a “cash-out” process.



10 Red Flags in LIHTC Deals

4. The investor limited partner claims its consent is necessary to consummate a ROFR or offers other roadblocks suggesting an exercise of the ROFR is difficult or cannot occur.
5. The investor limited partner begins discussing future planning, future values, future circumstances beyond year-15, like refinancing or re-syndication, as a means to generate proceeds to “buy them out” after year-15.
6. The investor limited partner begins to question otherwise routine financial reports or suggests that a forensic audit of past events is necessary for some reason.



10 Red Flags in LIHTC Deals

7. The investor limited partner suggests that Partnership liquidation should occur with its Year-15 Exit.
8. Forced Sale or Qualified Contract requests are presented, with suggestions of priority over ROFRs or Purchase Option rights.
9. Exit negotiations stall or you experience periods of non-responsiveness from your investor limited partner.
10. You are not adequately familiar with your documents and are discussing the limited partner's Year-15 Exit.



Thank you!



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