

Nonprofit Year-15 LIHTC Issues

LIHTC Track – Session Five



Arizona
Department
of Housing

Moderator:

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Speakers:

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A Troubling Trend in the LIHTC Industry

*A conversation on Year-15
Disputes*



Year 15-Exit Disputes



- Historical understanding and practices
- Emergence of Aggregators
- Litigation discussion

Aggregators



- “Affordable housing asset management” firms have been amassing investor interests in LIHTC partnerships.
- Treat the partnership agreements as purely financial instruments for generating profits, rather than projects intended to promote low-income housing.
- The Aggregators seek to extract maximum value from partners at the expense of low-income housing and the communities the program is designed to serve.
 - Leveraging economies of scale and resource disparities against partners to thwart transfers or obtain significant buyouts.

CED Capital Holdings 2000 EB, LLC

v. CTCW Berkshire Club, L.L.C.

2020 WL 6537072 (Fla.Cir.Ct. Nov. 3, 2020)



Florida Court recognizes several important industry concerns:

- *“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, ultimately to Hunt, that was never intended by the original tax credit investor or anyone originally involved in the Project.”*

CED Capital Holdings 2000 EB, LLC

v. CTCW Berkshire Club, L.L.C.

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- *“this type of activity has become more common in the LIHTC industry and the Court’s decision here is in accord with decisions from other, similar cases in different jurisdictions where parties, like Hunt, have come into LIHTC partnership agreements and attempted to extract value or proceeds that is not otherwise permitted under the operative contracts like the Partnership Agreement here.” (citing 9 cases and two sources)*

Year 15 Litigation



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

Various Tactics



- Dispute Section 42(i)(7) ROFR Sales.
 - Insist that there be a bona fide, enforceable and binding third-party offer to purchase a property regardless of what the Partnership Agreement may require.
 - Insist that LP consent rights provide the LP with sole discretion to accept a third-party offer.

ROFR Case Studies



- Minnesota
- Massachusetts
- Washington
- Florida
- New York
- Michigan

Various Tactics



- Dispute Purchase Options and Option Prices
 - Option to purchase Property versus LP Interests in a Partnership.
 - Insist on a BOV in lieu of an appraisal, notwithstanding the requirements of a Partnership Agreement.
 - 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.

Various Tactics



- Leveraging Recapitalization Opportunities.
 - Using consent rights to force a Hobson’s Choice as Partnership debt obligations become due.
 - Seeking to “participate” in re-syndication opportunities after LP exit.
 - Demanding Partnership reserve accounts be liquidated.

As I'm on the production side and new, my communication to DASH was v limited – essentially hearing them out and reminding them that we purchased the Midland portfolio based on residual value, which we now are needing to extract. (And then hearing her out again – pretty sure my #1 phrase was, "I hear you.")

Background to all this: the GP on these two deals has Options at greater of FMV or debt plus taxes. Neither FMV nor D+T will be a real high number, so I might not have much blocking leverage. Even though they're a small non-profit, they might be able to just pay us off to get rid of us. However, maybe this deal will be a bit small for most other syndicators, too? I dunno. I'm obviously trying to find a way to boost residuals and get you a deal worth doing, and feel like I'm kind of threading a pretty fine needle. But I don't feel like I'm way out in fantasy land.

Recommendation: While this is a pretty steep discount, and we suspect the GP doesn't really have the funding for a long legal fight, the maximum potential ILP value could be less than the cost of a long legal fight. I recommend getting what we can now and being done with it.

Various Tactics



➤ GP Removal Efforts

- Bad faith breach of fiduciary duty and contract claims
- Property Raids.
- The “Aggregator’s Playbook.”

g) CED committed no default under the LPA and no default had been declared by CTCW prior to CED's exercise of its Option. CTCW's efforts to declare defaults all took place after CED exercised its Option on February 9, 2018, after the parties both engaged in the appraisal process to determine the Project's value under the LPA, after Hunt Capital Partners took over management of CTCW, and after CED tendered the Purchase Price to CTCW. As such, CTCW's allegations of default were **baseless and intended to deprive** CED of its contractual right to purchase CTCW's interest in the Partnership pursuant to its purchase Option.

***10** 51. In December 2017, in response to the Hidden Hills litigation, Mr. Blake put into practice Alden Torch's policy of scrutinizing any other entities that share common principals with a general partner against whom Alden Torch is litigating. 6/5/19 Trial Tr. at 151-52, 159-60 (Blake); Trial Ex. 125. He instructed two Alden Torch forensic accountants to do a "**deep dive**" into Parkway's audited financial statements dating back to 2002, nine years before Alden Torch had any involvement in Parkway. 6/5/19 Trial Tr. at 160 (Blake). He pointed out as

Housing Authority Action



- 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, (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”)

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 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 the book entry through a “cash-out” process.



10 Red Flags in LIHTC Deals

4. The investor limited partner starts talking to you about 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.
5. The investor limited partner undertakes efforts to restrict or limit use of reserve accounts and withholding approvals for project needs.
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. Exit negotiations stall or you experience periods of non-responsiveness from your investor limited partner.
8. Qualified Contract requests are suddenly presented.
9. Discussions concerning liquidation of the Partnership are presented.
10. You are not adequately familiar with your documents and/or are talking to or fielding questions from your investor limited partner about their exit.



What Can be Done to Resist This Trend - Industry Awareness



- GPs should prepare to deal with LPs well before Year 15 by reviewing documents, consulting counsel and alerting HFA
- Developers must ensure counsel better design in protections partnership agreements
- HFAs should devote staff resources to working with GPs to protect existing affordable housing assets
- Federal, state and local policymakers should be briefed on what is occurring
- Affordable housing community should advocate for better protections

What Can be Done to Resist This Trend



- Federal legislation to clarify section 42(i)(7) for existing agreements and to provide for a purchase option for new deals
- HFA policies to protect the interests of nonprofits by:
 - Prohibiting or discouraging credit applicants from using equity providers who have refused to recognize ROFRs.
 - Requiring approval of any future transfers of investor interests
 - Requiring minimum standards for ROFR agreements
 - Working with nonprofits to prepare them to deal with investor in Year 15

Federal Legislation to Amend Section 42(i)(7)



- Change ROFR to Purchase Option for future deals and remove exit taxes from price
- Clarify current law
 - Reference to "property" includes all assets of partnership
 - Investor consent not required to exercise ROFR
 - Exercise of ROFR does not require bona fide offer and any entity, including a related party may make an offer
 - ROFR may be exercised through purchase of partnership interests as well as transfer of property
 - Clarifications would not supersede express language in agreement

Find Out More



- [Local Officials And Congressional Leaders Decry Investors Who Put Affordable Housing At Risk](#) - WBUR
- [Year 15 Dispositions: Navigating the Challenges with Purchase Options and Rights of First Refusal](#) – CHAM Webinar
- [10 Red Flags in LIHTC Deals](#) – David Davenport
- [Washington State Housing Finance Commission's 2019 white paper on Transfer Disputes in Nonprofit LIHTC project](#) — WSHFC
- [BOND / Tax Credit Program Policies \(wshfc.org\)](#) - WSHFC revised transfer policy, see Chapter 7, page 48
- [Investors Mine For Profits In Affordable Housing, Leaving Thousands Of Tenants At Risk](#) – WBUR

Questions



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