Y15 for North Carolina’s Low Income Housing Tax Credit Portfolio: Qualified Contracts, Preservation Opportunities and Exit Strategies

by

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Executive Summary

The Low Income Housing Tax Credit (LIHTC) has evolved into the primary means of production for low income rental housing in the United States. In 1989, Congress extended LIHTC program affordability and rent restrictions in order to further preserve affordable rental housing for citizens. Prior to 1990, LIHTC property owners could leave the program at the end of fifteen years. But with the reforms passed by Congress, projects after 1990 must now retain affordability and remain rent restricted for an additional fifteen years, leading to a thirty year minimum affordability period.

At the end of the fifteen year initial compliance period, Congress provided a way out for owners who, after gaining the benefits of the tax credits, want to sell their properties. This sales provision, known as the qualified contract in Section 42 of the Internal Revenue Code (IRC), was meant to balance investor interests with the interests of affordable housing preservation. However the qualified contract is not a straightforward real estate transaction; it is wrought with ambiguity and open to interpretation.

An evaluation of the North Carolina developments that received 1990 tax credits was completed in order to ascertain which properties would be both eligible and likely to request qualified contracts. Properties were evaluated to the extent that they had:

- no project based financial assistance
- for-profit ownership
- compliance periods ending in 2004 or 2005
- location in a high income county

One property - Fox Hollow Apartments in Wake County – met all four criteria. Teamwork for Housing, London Church Road Apartments, Vance County Housing, and River Terrace Apartments met three of the four criteria, with the exception being their location in middle and low income counties. In addition to this evaluation, owners and property managers were contacted in an effort to gain insight into plans for their properties. Seventeen of the nineteen owners and property managers who were successfully contacted indicated that they planned to keep their properties affordable. While these owners and property managers have similar preservation goals, there reasons for pursuing continued affordability varied greatly.

This assessment of 1990 tax credit properties revealed that the North Carolina Housing Finance Agency (NCHFA) will not get an influx of owners seeking qualified contracts. This, however, does not mean that affordable housing preservation is not an issue. In fact, as more households are increasingly housing cost-burdened, the preservation and viable operation of existing LIHTC properties will become increasingly important. The NCHFA, investor/owners, and municipalities must each play a role in helping to preserve affordable rental housing within their resource limitations and investment interests.
While the catastrophe that was supposed to be Y2K is a fleeting memory for most citizens, the impact of Y15 on the world of the Low Income Housing Tax Credit (LIHTC) has yet to materialize completely. Just as commentators prior to the new millennium varied in their opinion, some housing observers predict that the issues surrounding Y15 will significantly effect affordable housing supply, while others believe that the transition will come and go without incident. As some LIHTC properties approach the end of their fifteen year program compliance period, there is a growing uncertainty among state agencies, project owners and municipalities alike.

Y15 refers to a variety of events that will have an impact on a property’s ownership and regulation at the conclusion of the first fifteen years of operation. These issues include:

- The expiration of partnerships between the owners/limited partners and the general partner.
- The ending of IRS oversight of properties and enforcement of regulations.
- The need for new capital to refinance current debt and to provide for maintenance needs (Christian 1).

The year fifteen issues were created when Congress reformed the LIHTC program in 1989 to include an additional fifteen year extended affordability period for all LIHTC projects receiving tax credits. Prior to 1990, LIHTC property owners could leave the program at the end of fifteen years. But with the reforms passed by Congress, projects beginning in 1990 must now retain affordability and remain rent restricted for an additional fifteen years, leading to a thirty year minimum affordability period.

At the end of the fifteen year initial compliance period, Congress provided a way out for owners who, after gaining the benefits of the tax credits, may want to sell their properties. This sales provision, known as the qualified contract in Section 42 of the Internal Revenue Code (IRC), is not a straightforward real estate transaction. It is wrought with ambiguity and open to interpretation. The 1990 properties have now reached their Y15 and housing finance agencies, affordable housing advocates, developers, syndicators and owners are all waiting to see how this sales provision process will unfold.

Will the qualified contract process reduce the affordable housing stock in North Carolina? This analysis will begin with an overview of the tax credit program, the importance of affordable housing creation and preservation as it relates to the LIHTC program and the issues surrounding the qualified contract process. Focus will then shift to the properties that received 1990 tax credit allocations, looking at their eligibility for qualified contracts and surmising what property specific factors may affect an owners desire to seek a qualified contract. Results of interviews with owners and managers of these 1990 projects will then be presented and compared to the individual property analysis in order to garner further information about plans for the properties. The analysis will conclude with recommendations for the state housing finance agency, syndicators, owners, and municipalities.
The Low Income Housing Tax Credit Program - Overview

The Low Income Housing Tax Credit Program (LIHTC) was created with the passage of the Tax Reform Act of 1986. It was conceived as an incentive for investors and developers to produce affordable housing. With the generous tax benefits of the previous code removed, there was no longer any tax advantage in constructing housing for low income citizens. The LIHTC program was an attempt to eliminate that disincentive.

However, the long term prospects of the LIHTC program did not look good. With the inclusion of a three year sunset period written into the law, it appeared that the LIHTC program might experience an untimely death. The Omnibus Reconciliation Act of 1989 removed that sunset and the LIHTC program has now evolved into the primary means of production for low income rental housing in the United States.

The LIHTC program begins with the Internal Revenue Service (IRS) allotting each state an amount of tax credits based on their population. Credits are allocated on the basis of dollar amount per capita. In 2005, that amount equaled $1.85 per person - for North Carolina that resulted in nearly $16 million in federal tax credits.

These credits are given to state agencies that, through a highly competitive process, determine which developers will win the right to the credits. This competitive process is detailed in the Qualified Allocation Plan (QAP), which specifies the requirements and scoring procedures for the tax credit applications. There are many requisites for applications, including a minimum set aside of low income units, either 20% of the units must be at or below 50% of area median income (AMI) or 40% must be at or below 60% of AMI. There is also a cap on the amount of rents that can be charged. Rents, including other housing expenses, cannot exceed 30% of a tenant’s income. State housing agencies then review the tax credit applications and score them based on site suitability, market analysis, mortgage leveraging and other development criteria.

The credits themselves are worthless to the developer who needs equity to build the low income housing project. So once developers are awarded credits from the state agencies, they sell them to investors, through a syndicator. This syndicator organizes investors on behalf of the developer. The syndicator then facilitates, for a fee, the sale of the tax credits to the investor with investors paying a certain percentage on the dollar for every tax credit they receive. In the end, the general partner gets equity for the building of the project in exchange for tax credits which the investors can use as a one for one reduction in taxes. For instance, if the partners have $10,000 dollars in tax liability and have purchased $10,000 dollars worth of credits, they have no federal tax liability.

These investors and developer form a limited partnership (LP) or limited liability corporation (LLC) where the syndicator and investors own 99.9% of the project and the developer owns 0.01% of the project. The IRS considers LPs and LLCs as pass
through entities meaning that they have no tax liability. Tax liability passes through the corporation and directly onto the partners.¹ The investors become known as the limited partner (in the case of a LP) or a limited manager (in the case of a LLC) and the developer becomes known as the general partner (in the case of a LP) or general manager (in the case of a LLC). For the purposes of this paper, limited and general partnership terminology will be used to refer to the relationship between the investor and the developer.

While the limited partner(s) own a majority of the project they have little to do with the day-to-day functioning of the project and in fact they have the least amount of risk and accountability. The general partner is in charge of the day-to-day functioning and bears significant responsibility in terms of asset management and property compliance.

Tax implications for owners/limited partners in the LIHTC program are designed to last fifteen years. While the limited partners get their credits over an accelerated ten year period, the IRS monitors the project for an additional five years. If the state agencies that monitor the tax credit projects find occupancy, healthy, safety or building code violations, they report these to the IRS on what is know as Form 8823. The IRS can take action to recall, or recapture, the credits given to the investors at any time during this fifteen year period. For this reason, the general partners and management company must carefully scrutinize their policies, keep good records and maintain their properties in order to avoid the risk of tax credit recapture.

Once a building in a project is placed in service or certified for occupancy, an owner must file Form 8609 with the IRS. This form indicates to the IRS when the owner wants to begin taking credits. There must be a separate 8609 filed for each building in the project and once an 8609 is filed the credit start date cannot be changed.

As mentioned earlier, Congress in 1989 extended the original fifteen year compliance period for properties receiving credits in 1990 and following to include an additional fifteen year extended affordability period. This additional affordability period is recorded in a Land Use Restrictive Agreement (LURA) that is registered in the county where the LIHTC project resides. While this requires properties to remain affordable for a total of thirty years, after the first fifteen years, the IRS is no longer concerned with property compliance and monitoring since tax credits are no longer involved. However, the state agencies, in charge of continued monitoring, like the North Carolina Housing Finance Agency (NCHFA), want to continue to scrutinize compliance with LIHTC program regulations. Preserving the LIHTC properties so that they remain affordable and attractive places for low and moderate income households is a priority of all state housing agencies, including the NCHFA.

The Case for Affordable Housing Creation and Preservation

In 1949, a “decent home and suitable living environment” for all Americans was a declared a national policy goal when Congress passed the Housing Act. For over

¹ While there is a legal difference between limited license corporations and limited partnerships, for tax purposes there is essentially no difference.
fifty years, this pronouncement has guided federal housing policy with mixed results. Through various supply and demand side interventions, the government has attempted to provide, incentivize, and facilitate the construction and provision of affordable housing to those not served by the market. This has included homeless, elderly, disabled, and low income households. Traditionally, housing supply has been a government enterprise allowing developers to go to the government as a one stop source for their financing needs (Rohe 944). As government housing policy has evolved, federal government is no longer the primary lending and subsidy provider and has instead looked increasingly to the private sector. One of the more successful supply side programs has been the LIHTC program which has produced approximately 1.6 million affordable units since its inception (Hobbs). While the program has created many affordable living opportunities, there are still millions of Americans who are in need of a decent and suitable home.

In 1999, The Millennial Housing Commission reported that one in four—almost 28 million—American households spent more than 30 percent of their income on housing, the percentage that the federal government considers affordable and appropriate (Millennial Housing Commission 7). In 2005, not much has changed. A report released late last year by the National Low Income Housing Coalition (NLIHC) indicates that while the current minimum wage is $5.15/hour, the national housing wage – what it would take to rent a moderately priced two bedroom apartment given a forty hour work week – is $15.37/hour (NLIHC). There is no evidence to suggest that this gap between wages and affordable rents (as defined by 30% of income) are narrowing. In fact, indications are that the cost of living will continue to rise faster than wages, putting more and more people into situations where housing becomes a larger part of their living expenses (NLIHC). The report concludes that in no community, city, county, or state is housing affordable to low wage workers.

The statistics for North Carolina are just as disturbing. In order to rent a two bedroom apartment at Fair Market Rent (FMR), a price calculated by the Department of Housing and Urban Development (HUD) for a modest apartment that includes utilities, a North Carolina worker would have to work for $11.60/hour or 90 hours a week at minimum wage. In order to afford a one bedroom apartment, a worker would need to make $9.30/hour or work 76 hours a week at minimum wage. 41% of renters are unable to afford a two bedroom apartment at FMR and nearly 1 in 7 North Carolinians have a critical housing need which is defined as either 1) paying more than 50% of income toward housing, 2) having inadequate plumbing or kitchen facilities or 3) being overcrowded (Russo and Crossfield).

With even basic shelter becoming increasingly expensive, tax credit housing becomes a critical source of shelter for low and moderate income workers. The resolution of issues surrounding Y15 and the qualified contract process will be critical in determining whether North Carolina, and the nation, will be able to preserve and add to its affordable housing stock or whether the state will simply replace older stock that leaves the program.
The Qualified Contract Process – What happens at Y15?

Beginning in the fourteenth year of the compliance period, the owner(s)/limited partner(s) can approach the North Carolina Housing Finance Agency (NCHFA) and request that the Agency find a buyer for the project. The Internal Revenue Code (IRC) provides the Agency with one year to locate a buyer who will purchase the low income portion of the building at a preapproved price – the qualified contract price. This buyer must operate the project as affordable for the extended affordability period specified in the LURA. If the Agency cannot locate a buyer than the project owner can option out of the program. For three years following, the owner cannot evict a tenant for other than just cause and cannot raise rents above the maximum allowable. Once this three year vacancy decontrol period is over, the owner can do whatever they want with the property.

In order to understand the issues surrounding Y15 and the qualified contract process, it is useful to look at the issue from the perspective of state agencies (specifically the NCHFA), owners and municipalities.

North Carolina Housing Finance Agency

The NCHFA is the promoter, keeper, and financier of affordable housing in North Carolina. In regard to the Y15 issue, the NCHFA cares foremost about preserving affordability within their resource limitations and in a way that meets the needs of owners, tenants and the building itself. Unfortunately, the IRS code governing the qualified contract process does not easily allow these goals to be met.

In December 2004, the NCHFA released its qualified contract policy. The NCHFA is requiring owners to submit preliminary applications, giving notice that the owner intends to file a complete application, which will be accepted between January and May of each year. Nonrefundable fees are assessed for the preliminary and complete application and a deposit of up to $30,000 is required to cover third party costs associated with any transfer of ownership.

Eligibility and documentation requirements for owners seeking a qualified contract are extensive, requiring among many things, partnership tax returns for all the years that the project has received credits. While this may seem extreme, the NCHFA would argue that all the required documentation is necessary to arrive at an accurate qualified contract price as determined by the Internal Revenue Code (IRC). Not until

2 For the remainder of this paper, owner will be used in reference to the limited partner(s) who own 99.9% of any particular LIHTC property.

3 The qualified contract is defined as “a bona fide contract to acquire (within a reasonable period after the contract is entered into) the nonlow-income portion of the building for fair market value and the low-income portion of the building for an amount not less than the applicable fraction (specified in the extended low-income housing commitment) of the sum of the outstanding indebtedness secured by, or with respect to, the building, the adjusted investor equity in the building, plus other capital contributions not reflected [above], reduced by the cash distributions from (or available for distribution from) the project.”
all required documentation is submitted will the “one year clock” begin ticking for the NCHFA to find a buyer. For those properties without all the required documentation, the NCHFA will deem the property ineligible, allow for accountant interpolation of missing information, or permit any new owner to purchase the property at fair market value. An important clause allows any question over price to be interpreted at a lower value.

This policy, like many others proffered by housing finance agencies around the country, does not make it easy for owners to apply and then be offered a qualified contract. Clearly this is in the best interest of 1) preserving the projects as affordable over the extended use period and 2) conserving agency resources that would otherwise have to be dedicated to the process of gathering information, analyzing documents and brokering properties.

While the policy provides a clear standard for the qualified contract process, there are still many questions to be answered. These issues can be divided into roughly two broad headings: qualified contract calculation questions and administrative questions.

Calculation questions are aimed at attaining an accurate price for the property. Some of the issues include valuation for the nonlow-income portion of the project, the Code’s application of a cost of living adjustment to the adjusted investor equity but not to the cash distributions, and the treatment of contributions by the general partner. IRC Section 42 gives no guidance on these questions and it will be up to the NCHFA to form additional policy and to seek IRS rulings where support is needed. The clause that allows the NCHFA to resolve any calculation questions at a lower price is clearly an attempt to resolve potential computation issues that may occur during the process. Whether this clause will remain unchallenged is yet to be seen.

To further complicate calculation issues, it is the opinion of attorney Jerome Breed, an expert in the tax issues surrounding the LIHTC program, that in many cases the qualified contract price will be substantially above the fair market value of the property. In light of this possibility, the NCHFA will undoubtedly make decisions on the categorization of certain fees and contributions in favor of a lower qualified contract prices that more closely approach fair market value. For instance, the incentive management fee could be considered as cash distributed and therefore have this price reduction effect. Furthermore, in the absence of fifteen years worth of tax returns and financial statements, the NCHFA will allow owners to sell their properties at fair market value through the qualified contract process. Since most owners are unlikely to have all the required documentation necessary to calculate an accurate qualified contract price and since most accountants will be unable to

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4 The incentive management fee is money given to the general partner and/or management company out of excess cash flow. While it could be distributed to the limited partners, in general they do not want to take on cash that will have the effect of reducing their tax losses. It is called an incentive management fee because it is given as a “reward” for operating the property in such a way that it has excess cash flow.
correctly deduce missing information, this policy effectively ensures that no owner will be able to get substantially more for a property than it is worth.

The administrative questions involved in the qualified contract process involve issues of timelines in which owners can apply for qualified contracts, qualifications and legality of the NCHFA as a broker in a real estate transaction, the requirement of standard contract terms, and the possible need to ensure the closing of the transaction. While the NCHFA’s qualified contract policy attempts to address these questions, they do so without precedent and without guidance from the Code.

In the case of the rental development division of the NCHFA (which administers the LIHTC program), there is no interest in taking on additional responsibilities of owner or broker which are outside of the original intent of the program. Therefore, the agency will not seek to purchase any of the properties that apply for qualified contracts nor will they want to take on the obligations that come with making sure that both owners of expiring properties and interested buyers complete a real estate transaction. In fact, according to Mark Shelburne the rental investment attorney at NCHFA, the obligation for the NCHFA, under Section 42(h)(6)(E)(i)(II), is to “present” a contract for the statutory price. The NCHFA policy reflects this position and in doing so eliminates responsibility for brokering a transaction and thereby prevents a project from terminating its extended use period due to a failed negotiation.

Owners/Investors

The owners of expiring tax credit properties have received all their tax benefits over the first ten years and have met their compliance obligations under the IRC Code for fifteen years. Owners will want to sell their properties, especially if they are producing little or no cash flow and if there is a need for extensive recapitalization in order to revitalize the property.

When the owner/investor enters into the limited partnership or limited liability corporation with the general partner, they execute a partnership agreement which lays out the terms, rights and responsibilities of each party in regard to the particular LIHTC property. Many times this general partnership agreement will contain clauses which allow for the general partner to buy out the investors share in the property without an offer from a third party. This is known as a buyout option.

Other partnership agreements may contain a right of first refusal which allows a non profit, government agency or tenants association to purchase the property at the close of the compliance period, according to Section 42(i)(7), for a minimum purchase price of the principal amount of outstanding indebtedness secured by the building plus all federal, state and local taxes attributable to the sale.

While the right or first refusal price will almost always be lower than the fair market value and the qualified contract price, many investor limited partners want out of the property and would be amenable to selling to a non-profit general partner or other
eligible group. However, most non-profits and tenants groups will find it difficult to access the funds needed to purchase and maintain a tax credit property (Pitcoff). The non-profit entity may also not prefer to invest in the property because it has very little or no equity. This may lead the owner/investor to pursue a qualified contract once the non profit general partner or other non profit have agreed not to exercise their right of first refusal option in the form of a quitclaim deed that will clear the title (Shellan, Part 2, 6).

In either case the owner may come out a winner. If the non profit fails to purchase the property then the investor limited partner will benefit because the project will either be sold for is market value considering the rent restrictions (if such a clause existed in the general partnership agreement) or at the qualified contract price, which as noted earlier will in many cases be higher than the fair market value.

Many owners may view the qualified contract process as a way to turn their property to market hoping that no buyer will come forward to purchase the property for the qualified contract price. For many of the properties allocated credits in 1990, the markets in which these properties exist may now be able to support higher rents or other uses. For properties where this scenario exists, these owners/investors may convert the property to market rate rentals, condominiums or commercial developments.

However, if there are additional affordability restrictions imposed by the financing either in its terms and maturity or in its affordability and use restrictions, then investors may have more limited options when pursuing the sale of their property. The North Carolina State Low-Income Housing Tax Credit, project based financial assistance, in the form of the HUD Section 8 program or in the Rural Housing Service’s 515 loan program, contain these types of additional constraints.

Municipalities

Many county and local government officials are unaware of the expiring affordability issues of the LIHTC properties that exist within their jurisdictions. While it may seem that the Y15 issue exists primarily in the realm of the housing finance agencies and investor/owners, unprepared officials may soon find that the affordable and rent restricted housing stock provided by the LIHTC program is converting to market.

The focus of county and local governments is the public benefit of the LIHTC property in terms of its ability to service low and moderate income renters and/or special needs populations. The evaluation by local governments of this benefit falls generally into two areas: the quantity, quality, and affordability of the housing and the cost of supporting that housing with funds under the government’s control (ESIC Financial Underwriting).

Local governments have at their disposal funding that will allow them to address this first interest. The Home Investment Partnership Program (HOME) and the

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5 Eligible groups refer to those organizations noted in the previous paragraph – government agencies, non profit groups and tenant associations.
Community Development Block Grants (CDBG), as well as other funding sources, provide flexibility in meeting needs of low and moderate income households. HUD, which issues both HOME and CDBG funds, requires the formation of a Consolidated Plan that outlines the needs and goals of the communities in which the funding will be used. As these monies are spent HUD requires documentation that shows expenditures are in line with the Consolidated Plan. While municipalities may not own the LIHTC properties, in many cases they have provided funding in the form of grants and low interest loans to the developer/general partner as leverage against other funding sources. It is these sources of funding that fill the gap and make the construction of LIHTC properties feasible. The funding from county and local governments may come with additional restrictions that limit use and extend affordability.

And while towns and counties have these funding sources that allow them to address housing issues, the demand for these funds always exceeds their supply. Public entities, therefore, have interest in minimizing their investment in affordable housing while still meeting quality and quantity goals. This may leave many municipalities in a lurch when it comes to addressing the expiring affordability of the LIHTC properties. Local governments may have committed funds to other needs or are not able to address rehabilitation of tax credit housing because it is not part of their Consolidated Plan.

Summary

Although the NCHFA and municipalities may approach the Y15 issues with differing degrees of interest and expertise, their concerns converge around the issue of preservation. Owners vary in their perspective. Those owners with a for-profit motive that are saddled with a property lacking cash flow to meet capital needs are chiefly concerned with selling the property now that they have realized all the tax benefits. Those owners that may face excessive exit taxes may, in turn, have no interest in selling the property. Differing motivations, tax situations, financing arrangements and partnership agreements will all dictate what owners are likely to do as their properties reach the fourteenth year of compliance.

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6 President Bush, in an effort to consolidate what he sees as duplicate programming, has recently proposed that the CDBG program be moved from HUD to the Commerce Department. Congressional housing aides believe that this will result in as much as a 50% reduction in CDBG funding (Weisman A1). Community development advocates and city leaders are protesting the proposal, citing the negative impact it would have on cities.

7 Some CDBG funds are allocated directly to cities and large metropolitan areas. These are known as entitlement communities and they develop their own goals and funding priorities. Other CDBG funds go directly to the state which administers their dispersal (for North Carolina, the NCHFA also administers these funds) to smaller towns and counties. In this situation, the state develops a consolidated plan and then gives funds to local governments that carry out development activities in line with the goals of this plan. HOME funds are allocated to states and local governments based on a funding formula and are designed to meet the housing needs of those with the lowest incomes. CDBG funds can be used for purposes other than housing and have more flexibility in terms of the population they serve.
While Y15 is here for some of these properties and with a few states already receiving requests for qualified contracts, the affect the qualified contract process has on the affordable housing stock will not be determined for many years. IRC Section 42 states that owners can apply for a contract anytime after the fourteenth year. There is no expiration on the application timeframe; this means that owners would be free to request qualified contracts anytime after year 14.

In the years to follow, the number of properties that may be eligible for qualified contracts will continue to grow. State agencies and local governments must be prepared for the possibility that many owners will try and opt out of the LIHTC program. The following analysis of North Carolina properties that received 1990 tax credit allocations is designed to provide a framework for the types of properties that are at risk of converting to market and how the NCHFA can prepare for qualified contract applications.

1990 North Carolina Tax Credit Properties

Overview

There are 87 projects that were allocated tax credits in 1990. Of these 87 projects, 31 have ten or more low income units. In the early stages of the tax credit program, it had been the policy of the NCHFA to allocate credits, not only to multi-unit, single site projects but to single unit, duplexes and scattered site projects as well. As the tax credit program has grown in its popularity and competitiveness, NCHFA no longer allocates credits to single unit deals because these credits are optimized through allotment to multi-unit deals. Due to limited monitoring resources, preservation of these earlier single units is not a priority. Therefore, this analysis focuses on the properties that contain ten or more low income units in which the NCHFA is likely to have interest in preserving (see Appendix A for data collection information).

While there are 31 properties with more than ten low income units that received tax credits in 1990, three properties were removed from the following analysis.8 Lincoln Grove Apartments is considered in this analysis even though it received additional tax credits in 1991 and 1992. These additional allocations will, according to NCHFA qualified contract policy, delay the owners’ ability to apply for a qualified contract until 2006 or 2007. An additional project – Fox Hollow Apartments – was added to the analysis because while it received ten distinct tax credit allocations in 1990, it is essentially one development made up of ten single, separate units. Therefore, twenty-nine units are included in the “Overview of 1990 Properties with 10 or More Low Income Units” table.

The following information was extracted from property files and the NCHFA’s Rental Compliance Reporting System (RCRS) and provides a baseline for evaluating the

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8 These properties were Merrywood, Carver Creek and Everitt Street. Merrywood was never built, Carver Creek surrendered their 1990 credits and were reallocated credits in 1992 and Everitt Street terminated its participation in the tax credit program.
eligibility and the likelihood of properties applying for qualified contracts. The significance of each variable is explained in detail.

Table 1 Key

<table>
<thead>
<tr>
<th>Name</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Name</td>
<td>Name of project, taken directly from the NCHFA’s online reporting system, RCRS</td>
</tr>
<tr>
<td>NCHFA First Building PIS</td>
<td>The date the first building in the project was placed into service according to NCHFA’s online reporting system.</td>
</tr>
<tr>
<td>NCHFA Last Building PIS</td>
<td>The date the last building in the project was placed into service according to NCHFA’s online reporting system.</td>
</tr>
<tr>
<td>Owner First Building PIS</td>
<td>Date first building in the project was placed in service according to IRS Form 8609 Part II, Section 1a, the section completed by the building owner.</td>
</tr>
<tr>
<td>Owner Last Building PIS</td>
<td>Date last building in the project was placed in service according to IRS Form 8609 Part II, Section 1a, the section completed by the building owner.</td>
</tr>
<tr>
<td>Credit Start</td>
<td>The year in which the owner elected to begin the credit period.</td>
</tr>
<tr>
<td>Mult_Building</td>
<td>Is the building part of a multiple building project?</td>
</tr>
<tr>
<td>Mixed Income</td>
<td>Does the project contain market rate units?</td>
</tr>
<tr>
<td>PBFA</td>
<td>Does the project receive project based rental assistance? FmHA = Rural Development 515 loan program; HUD = HUD Section 8 program</td>
</tr>
<tr>
<td>Extended Use</td>
<td>How many years beyond the compliance period must the project remain income and rental restricted?</td>
</tr>
<tr>
<td>Name</td>
<td>NCHFA First Building PIS</td>
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<tr>
<td>-------------------------------------</td>
<td>--------------------------</td>
</tr>
<tr>
<td>Meadowgreen Apartments III</td>
<td>12/21/1990</td>
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<td>Spencer Street Apartments</td>
<td>7/19/1991</td>
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<td>London Church Road Apartments</td>
<td>7/1/1991</td>
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<tr>
<td>River Terrace Apartments</td>
<td>9/18/1990</td>
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</tbody>
</table>

*On IRS Form 8609 Part II, Sec 5a, the owner indicates a desire to begin the credit period for one building in the year after the building is placed in service. For the remaining buildings, the owner indicates that Seneca Woods Limited Partnership wants to begin the credit period during the tax year that the buildings were placed in service.

**The owner claims in IRS Form 8609 Part II, Sec 2b that one building is not part of a multiple building project. However the other two buildings in the project are claimed to be part of a multiple building project.

The owner claims in IRS Form 8609 Part II, Sec 2b that one building is not part of a multiple building project. This will likely make the owners ineligible for a qualified contract until 2006 or 2007, depending on when the building(s) were placed in service.

According to NCHFA records, Lincoln Grove Apartments received tax credit allocations in 1990, 1991 and 1992. This will likely make the owners ineligible for a qualified contract until 2006 or 2007, depending on when the building(s) were placed in service.

For the purposes of evaluation, Fox Hollow Apartments is considered a single 1990 tax credit property. In reality, 10 different units applied for and received tax credit allocation in 1990.

With only one exception, all tax credit buildings comprising Fox Hollow Apartments claim that they will not "elect to begin credit period the first year after the building is placed in service (Section 42(c)(3))." Tax Credit Property 0562C has a revised 8609 form signed in March 2003 that does not include information present on the original 8609s. Tax Credit Property 0562H does not have a placed in service date in the owner's section.
Qualified Contract ‘Eligibility’ Factors

Placed in Service

Placed in service is defined by the IRS as the date any particular building in a LIHTC project is certified as being suitable for occupancy in accordance with state or local law. This date is important in determining when the fifteen year compliance period will begin.

In collecting information on each of the 1990 properties, there were some discrepancies between what the NCHFA recorded and what the owner indicated regarding placed in service dates on buildings in the same tax credit project. In many cases, the placed in service dates according to the NCHFA match with the placed in service dates of the owners. In other cases, they differ by a couple of days or by a few months. For the sake of comparison, both NCHFA’s database placed in service dates and the owner’s IRS Form 8609 Part II placed in service dates were presented in Table 1.

For example, River Terrace Apartments, which is a multiple building project, has both its first building and last building placed in service on 9/18/1990 according to NCHFA’s database, and 9/19/1990, according to the owner’s IRS Form 8609, Part II. River Terrace also received a tax credit allocation in 1989 but according to NCHFA qualified contract statutes it will not start the clock on its fifteen year compliance period until 1990, the last year of its multi-year allocation.

Beginning of Tax Credit Period

Only 8 of the 24 projects answered “yes” in electing to begin the credit period the first year after the building was placed in service. 15 elected to start the credit period during the tax year that the building was placed in service (see Table 2). Once the tax credit period begins the fifteen year compliance period begins as well. IRC Section 42(i)(1) defines the compliance period, with respect to any building, as “the period of 15 taxable years beginning with the first taxable year of the credit period.” If the first year of the credit period was 1991, then the fifteen year compliance period would conclude on December 31, 2005.

Continuing the earlier example, River Terrace Apartments had its last building placed in service in 1990. However, it elected to begin taking its credits the following year. This means that, barring other issues, this property will conclude its compliance period at the end of 2005. In comparison, the Charleston Apartments had their last building placed in service in 1990 as well. Yet the owners elected to begin their credits that same year. This property will therefore complete its compliance period at the conclusion of 2004.

Multiple Buildings

According to the 8609s, 17 of the 28 projects have indicated that there are multiple buildings receiving tax credit allocations. The NCHFA has adopted the opinion of
tax attorney Jerry Breed of Powell, Goldstein, Frazer and Murphy LLP, that housing finance agencies should be able to open up requests for qualified contracts from owners only after the building with the latest placed in service date has entered the fourteenth year of its compliance period.

Mixed Income

LIHTC project monitoring forms indicate that there are no mixed income properties. This eliminates the difficulty of determining whether or not to require owners whose projects received 1990 credit allocations, to make separate calculations for market rate units and low income units. According to the IRC, the presence of market rate units has no bearing on qualified contract price calculations. Fair market value, in a separate calculation, determines the price of the market rate component of a project.

Project Based Rental Assistance

When affordability restrictions are in place, such as the fifty year affordability requirements designated by the Rural Housing Service 515 loan program (now referred to as Rural Development), conversion risk is minimized. Other loans through state or local entities may have similar restrictions that will require properties to remain affordable beyond the initial fifteen year compliance period.

Of the 28 projects with ten or more low income units, 12 have some form of project based rental assistance. 9 have Rural Housing Service 515 loans while 2 have HUD Section 8 assistance. 1 project, Rockmoor Apartments, has both Rural Development and Section 8 support. The stipulations in the 515 loans and the renewal/expiration of Section 8 HAP contracts during the fifteen year compliance period will further determine whether these projects remain rent and income restricted. These projects will, more than likely, not be eligible for qualified contracts in the near future.

Extended Use Agreement

While the IRS states clearly that LIHTC projects must extend affordability for at least an additional 15 years past the compliance period (for a total of 30 years of affordability), the LURAs differ greatly in the number of years that they require projects to extend the Section 42 income and rental restrictions (see Table 2). The LURAs for each of the 29 projects (one LURA, for Kings Grant Court, was not readily accessible) are all similar in their structure and phrasing.
Table 2: 1990 Properties – Summary Statistics

<table>
<thead>
<tr>
<th>Start Credit Period*</th>
<th>Percent of 25</th>
<th>Multiple Buildings</th>
<th>Percent of 27</th>
<th>Mixed Income</th>
<th>Percent of 29</th>
<th>Project Based Assistance</th>
<th>Percent of 29</th>
<th>Extended Use</th>
<th>Percent of 28</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>4.0%</td>
<td>Yes</td>
<td>59.3%</td>
<td>Yes</td>
<td>0%</td>
<td>FmHA</td>
<td>34.5%</td>
<td>0 years</td>
<td>28.6%</td>
</tr>
<tr>
<td>1991</td>
<td>48.0%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>HUD</td>
<td>10.3%</td>
<td>11 years</td>
<td>42.9%</td>
</tr>
<tr>
<td>1992</td>
<td>36.0%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>15 years</td>
<td>21.4%</td>
</tr>
<tr>
<td>1993</td>
<td>12.0%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>35 years</td>
<td>7.1%</td>
</tr>
<tr>
<td>N = 25</td>
<td>N = 27</td>
<td>N = 29</td>
<td>N = 29</td>
<td>N = 29</td>
<td>N = 29</td>
<td>N = 28</td>
<td>N = 28</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Missing = 4</td>
<td>Missing = 2</td>
<td>Missing = 0</td>
<td>Missing = 0</td>
<td>Missing = 0</td>
<td>Missing = 1</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*For those properties where there are two years listed for the beginning of the credit period, the earlier date was selected.*
Qualified Contract ‘Likelihood’ Factors

Placed in service dates and additional affordability covenants provide guidance on when properties might be eligible to receive qualified contracts; this information does not, however, indicate which owners are likely to approach the NCHFA for contracts.

Type of Owner

In the absence of other affordability restrictions, it is assumed that for-profit general partners would be more likely to seek the conversion of the property to market rate than would a non-profit at the end of the initial fifteen year compliance period. For-profit general partners may want to realize the increase in value gained through the appreciation of the property while non-profit general partners usually have greater interest in keeping the property affordable (Beesemyer and Falk 14).

Beginning in 1990 all LIHTC projects have additional affordability restrictions of at least fifteen years beyond the initial compliance period. However, owners that have projects located in strong rental markets, where the potential income generated through higher rents in the market exceeds that of the rental income increases allowed by the LIHTC program, may seek a qualified contract. The hope may be that a qualified contract will not be offered thereby freeing the property to achieve market rate rental. The owner may also anticipate a buyer paying more than the fair market value through the qualified contract process allowing the owner to pursue other more profitable investments.

County Income Level and Fair Market Rent

For the purposes of this analysis, it is posited that higher median income counties will have more tax credit properties in sub-markets where conversion may be attractive to owners than in moderate or lower median income counties. In lower median income areas, it is assumed that there is less profitability (and therefore less probability) in potential conversions than in higher median income areas. Even if conversions to market rate units in lower median income areas were to occur, many tenants would experience negligible increases in rents (15). This would not be the case for tenants living in tax credit properties in higher income regions. In the following individual property analysis, the Fair Market Rents (FMRs), which are highly correlated with county income levels, will be used to compare what an owner may charge for a similar unit on the market versus the current tax credit rents that are being charged to tenants.

All twenty nine projects were evaluated on four indicators as a way of assessing owners’ ability to seek and to obtain a qualified contract (see Table 3):

- Compliance Period End Date
- Project Based Financial Assistance
- Type of Owner
- County Income Level
The year listed in the Compliance Period End Date column indicates the year in which the property will have completed its fifteen year compliance period. These years were calculated by using the placed in service dates and the owners’ preference for beginning credits either in the year the building was placed in service or in the subsequent tax year. The compliance period will end for all these properties on December 31 of the year listed. This means that these properties will be allowed to begin the qualified contract process starting on January 1 of the year listed.

In this analysis, for a property to be considered as a potential candidate for a qualified contract, it must:

- not have project based financial assistance that would preclude the owners from applying for a qualified contract,
- have a for profit owner,
- be in a high income county and
- have compliance periods ending in 2004 or 2005.

This evaluation places emphasis on the properties with compliance periods ending in 2004 and 2005, while acknowledging that properties with compliance periods ending in 2006 and 2007 may be as likely or more likely to request qualified contracts. Where properties have two different years listed, the more recent, and therefore most conservative, date is assumed to be accurate. 9

The following property met all four indicators measuring owners’ eligibility and interest in seeking a qualified contract:

- Fox Hollow Apartments

The remaining four properties have compliance dates ending within the next two years, lack project based financial assistance and have for-profit owners but are not located in high income level counties. They are:

- Teamwork for Housing
- London Church Road Apartments
- Vance County Housing
- River Terrace Apartments

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9 With the exception of Fox Hollow Apartments, those properties that have two years listed did not have owner signed 8609s indicating what year they wanted to begin their credits. Based on placed in service dates from either RCRS or the 8609s, both possible years were given. A definition of the other three indicators is provided in the Table Key above.
<table>
<thead>
<tr>
<th><strong>Table 3 Key</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>County</strong></td>
</tr>
<tr>
<td><strong>Low _Inc_Units</strong></td>
</tr>
<tr>
<td><strong>Comp_End</strong></td>
</tr>
<tr>
<td><strong>Owner Type</strong></td>
</tr>
<tr>
<td><strong>Income Level</strong></td>
</tr>
<tr>
<td><strong>Extended Use</strong></td>
</tr>
</tbody>
</table>
### Table 3: Properties Likely to Seek Exit from the LIHTC Program

<table>
<thead>
<tr>
<th>Name</th>
<th>Low_Inc_Units</th>
<th>County</th>
<th>Comp_End</th>
<th>PBFA</th>
<th>Owner Type</th>
<th>Income Level</th>
<th>Extended Use</th>
</tr>
</thead>
<tbody>
<tr>
<td>Seneca Woods</td>
<td>50</td>
<td>Mecklenburg</td>
<td>2007*</td>
<td>No</td>
<td>Non-Profit</td>
<td>High</td>
<td>15</td>
</tr>
<tr>
<td>Pungo Village</td>
<td>38</td>
<td>Beaufort</td>
<td>2006</td>
<td>FmHA</td>
<td>Non-Profit</td>
<td>Low</td>
<td>15</td>
</tr>
<tr>
<td>Sheffield Manor</td>
<td>36</td>
<td>Chatham</td>
<td>2005</td>
<td>FmHA</td>
<td>For-Profit</td>
<td>High</td>
<td>35</td>
</tr>
<tr>
<td>Currin Apartments</td>
<td>16</td>
<td>Harnett</td>
<td>2005</td>
<td>FmHA</td>
<td>For-Profit</td>
<td>Moderate</td>
<td>11</td>
</tr>
<tr>
<td>Ridgecrest Apartments</td>
<td>32</td>
<td>Johnston</td>
<td>2006</td>
<td>FmHA</td>
<td>For-Profit</td>
<td>High</td>
<td>0</td>
</tr>
<tr>
<td>Meadowgreen Apartments III</td>
<td>32</td>
<td>Rockingham</td>
<td>2004 or 2005</td>
<td>FmHA</td>
<td>For-Profit</td>
<td>Low</td>
<td>0</td>
</tr>
<tr>
<td>Elk Court Apartments</td>
<td>40</td>
<td>Surry</td>
<td>2005</td>
<td>FmHA</td>
<td>For-Profit</td>
<td>Low</td>
<td>0</td>
</tr>
<tr>
<td>The Charleston Apartments</td>
<td>32</td>
<td>Swain</td>
<td>2004</td>
<td>FmHA</td>
<td>For-Profit</td>
<td>Low</td>
<td>11</td>
</tr>
<tr>
<td>N. Warrenton Village</td>
<td>18</td>
<td>Warren</td>
<td>2005</td>
<td>No</td>
<td>For-Profit</td>
<td>Low</td>
<td>15</td>
</tr>
<tr>
<td>Teamwork for Housing</td>
<td>19</td>
<td>Davidson</td>
<td>2005 or 2006</td>
<td>No</td>
<td>For-Profit</td>
<td>Moderate</td>
<td>11</td>
</tr>
<tr>
<td>The Village at Stone Creek</td>
<td>56</td>
<td>Randolph</td>
<td>2007</td>
<td>No</td>
<td>For-Profit</td>
<td>Moderate</td>
<td>11</td>
</tr>
<tr>
<td>Kent Street Apartments</td>
<td>12</td>
<td>New Hanover</td>
<td>2005</td>
<td>HUD</td>
<td>Non-Profit</td>
<td>High</td>
<td>15</td>
</tr>
<tr>
<td>Spencer Street Apartments</td>
<td>20</td>
<td>Guilford</td>
<td>2006</td>
<td>No</td>
<td>Non-Profit</td>
<td>High</td>
<td>15</td>
</tr>
<tr>
<td>Lincoln Grove Apartments**</td>
<td>17</td>
<td>Guilford</td>
<td>2006</td>
<td>No</td>
<td>For-Profit</td>
<td>High</td>
<td>11</td>
</tr>
<tr>
<td>Lincoln Grove Apartments**</td>
<td>24</td>
<td>Guilford</td>
<td>2006</td>
<td>No</td>
<td>For-Profit</td>
<td>High</td>
<td>11</td>
</tr>
<tr>
<td>Woodcroft Apartments</td>
<td>112</td>
<td>Buncombe</td>
<td>2006</td>
<td>No</td>
<td>For-Profit</td>
<td>Moderate</td>
<td>11</td>
</tr>
<tr>
<td>Ridley Street M</td>
<td>16</td>
<td>Franklin</td>
<td>2006 or 2007</td>
<td>No</td>
<td>For-Profit</td>
<td>Moderate</td>
<td>0</td>
</tr>
<tr>
<td>Mashburn Gap Apartments</td>
<td>34</td>
<td>Madison</td>
<td>2006</td>
<td>FmHA</td>
<td>For-Profit</td>
<td>Low</td>
<td>11</td>
</tr>
<tr>
<td>Black River Village Apartments Phase II</td>
<td>32</td>
<td>Harnett</td>
<td>2006</td>
<td>FmHA</td>
<td>For-Profit</td>
<td>Moderate</td>
<td>0</td>
</tr>
<tr>
<td>Senior Village</td>
<td>30</td>
<td>Cleveland</td>
<td>2005</td>
<td>No</td>
<td>For-Profit</td>
<td>Moderate</td>
<td>15</td>
</tr>
<tr>
<td>Rockmoor Apartments</td>
<td>12</td>
<td>Avery</td>
<td>2006</td>
<td>FmHA, HUD</td>
<td>For-Profit</td>
<td>Low</td>
<td>35</td>
</tr>
<tr>
<td>Vance County Housing</td>
<td>10</td>
<td>Vance</td>
<td>2005 or 2006</td>
<td>No</td>
<td>For-Profit</td>
<td>Low</td>
<td>0</td>
</tr>
<tr>
<td>London Church Road Apartments</td>
<td>26</td>
<td>Wilson</td>
<td>2005</td>
<td>No</td>
<td>For-Profit</td>
<td>Moderate</td>
<td>0</td>
</tr>
<tr>
<td>King's Grant Court</td>
<td>36</td>
<td>Iredell</td>
<td>2007</td>
<td>HUd</td>
<td>Non-Profit</td>
<td>High</td>
<td>0</td>
</tr>
<tr>
<td>Village Green Apartments</td>
<td>42</td>
<td>Onslow</td>
<td>2006</td>
<td>No</td>
<td>For-Profit</td>
<td>Moderate</td>
<td>11</td>
</tr>
<tr>
<td>River Terrace Apartments</td>
<td>42</td>
<td>Robeson</td>
<td>2005</td>
<td>No</td>
<td>For-Profit</td>
<td>Low</td>
<td>8</td>
</tr>
<tr>
<td>Fox Hollow Apartments*</td>
<td>10</td>
<td>Wake</td>
<td>2005 or 2006</td>
<td>No</td>
<td>For-Profit</td>
<td>High</td>
<td>11</td>
</tr>
</tbody>
</table>

*This eligibility year for a qualified contract assumes that the North Carolina Housing Finance Agency will not entertain qualified contract requests from any project until the last building in the project has reached the fourteenth year of its compliance period. For Seneca Woods, if one building opted to take its credits the year after it was placed in service (1992) then the compliance period would start in 1993 and end on December 31, 2007.

** Lincoln Grove Apartments received tax credit allocations in 1990, 1991 and 1992 according to NCHFA records. This will likely make the owners ineligible for a qualified contract until 2006 or 2007, depending on when the building(s) were placed in service.

#This analysis assumes that Fox Hollow Apartments are a single tax credit property. In reality, Fox Hollow Apartments are ten separate tax credit properties that each received tax credits in 1990. This could mean that nine properties apply for qualified contracts in 2005 while one property would have to wait until 2006. Due to the separate allocations that each property received, it would be difficult for the North Carolina Housing Finance Agency to make a case that Fox Hollow Apartments are one tax credit property and therefore can be offered only one qualified contract.

##With only one exception, all tax credit buildings composing Fox Hollow Apartments claim that they will not "elect to begin credit period the first year after the building is placed in service (Section 42(d)(3))."
**Fox Hollow Apartments**

Fox Hollow Apartments is a ten unit, scattered site development, with each unit owned by a different owner and each unit receiving separate tax credit allocations. This makes each owner eligible for a qualified contract.

According to records, nine owners will be eligible to apply for a qualified contract in 2005. While two owners were cited for program violations (one of the violations was for major health, safety and building code problems), these violations have been corrected and should not pose any difficulty if the owners decide to request a qualified contract.

Since each apartment is owned by a different for-profit owner in a high income county, Fox Hollow owners may see greater revenue potential if the properties were to convert to the market than if they remained in the LIHTC program. According to the statistics provided by the Department of Housing and Urban Development (HUD), the FMR for a two bedroom apartment in Wake County in 2005 is $779. The HUD FMR, which is the estimate for a modest two bedroom apartment including utilities, provides some guidance on what the owners could receive as rental income in the marketplace. The current owners, however, are not receiving these rents even when the utility reduction is taken into consideration. NCHFA records indicate that two bedroom units are generating maximum rents of $650. Some submarkets within Wake County will obviously demand more than the FMR and if Fox Hollow is in one of these submarkets, then this will only increase the possibility that owners may seek a qualified contract in hopes that there will be no interested buyers.

**Teamwork for Housing**

As a 19 unit LIHTC project in Davidson County, Teamwork for Housing will be eligible for a qualified contract in either 2005 or 2006. It cannot be stated precisely which year the property will be eligible for a qualified contract because current records do not indicate when the owner decided to place the buildings in service.

Teamwork for Housing is operated by for-profit owners in a moderate income county with no additional affordability restrictions required by the financing, Teamwork for Housing owners may believe that the qualified contract process is their best opportunity to convert to either market rate rental or to another use. This decision will depend on many factors, including whether the submarket in which Teamwork is located is able to support higher rents that would make conversion feasible. Currently, the HUD fair market rate for a two bedroom apartment in Davidson County is $627. In comparison, the per unit income, not including utilities, currently generated by each two bedroom unit in the Teamwork project ranges from $310 dollars to $325 dollars over the past two years.

**London Church Road Apartments**

London Church Road Apartments is a for-profit owned development with no project based financial assistance and is eligible for a qualified contract application in 2005. It is located in a middle income county.
Fair market rent for a two bedroom apartment in Wilson County is $558. Income generated by the two bedroom units over the past two years ranges from $304-$350. When reducing the fair market rent by utilities, this potential difference in rental income may be enough of an inducement to seek a qualified contract.

The most pressing issue with London Church Road Apartments is the fact that they have not waived their qualified contract rights. The NCHFA now obliges owners to record a thirty year extended use agreement in the LURA stating, among other requirements, that the owner will not apply for relief under Section 42(h)(6)(E)(i)(II) of the Code. This section allows for the offering of a qualified contract should no buyers be willing to maintain the low income status of the property. Beginning in 1990 the Agency offered a point in the QAP application for each year waived. In some cases, including London Church, the properties decided to forgo these points altogether. Without this waiver in place the owners can seek to leave the LIHTC program after fifteen years. In this case, the owner would still be subject to the three year vacancy decontrol period under the IRC Code.

**Vance County Housing**

Vance County Housing is similar to London Church Road Apartments although it is located in a low income county. While the year in which the owners can apply for a qualified contract is uncertain, the fact that there is no waiver of qualified contract rights raises concern.\(^\text{10}\) Unlike London Church Apartments however, Vance County has only 10 low income units in the development.

In Vance County, fair market rent is $486 dollars for a 2 bedroom apartment. Currently, the 2 bedroom apartments in the complex are producing rental income ranging from $310 to $325 per unit. This information matters little if in fact Vance County is released from any additional affordability restrictions that come with the obligations of an extended use agreement.

**River Terrace Apartments**

River Terrace Apartments received tax credit allocations in both 1989 and 1990. Current NCHFA policy dictates that the compliance period would not begin until 1990 – the latest year in which credits were received. Prior to 1989, there were no extended use statutes in place in the LIHTC program. Starting with the 1990 allocation year, QAPs dictated that extended use periods of fifteen years or more be written into the LURAs.

Like Vance County Housing, River Terrace Apartments is located in a low income county and the LURA does not include a qualified contract waiver.

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\(^\text{10}\) For information on why the date on which the owners can apply for a qualified contract is not certain, see Teamwork for Housing section above.
Additional Properties - Senior Village and North Warrenton Village

Senior Village meets three of the four criteria used in measuring the likelihood of property owners requesting a qualified contract. It is a for profit owned development, in a middle income county with no project based financial assistance and eligible for qualified contract application in 2005. However, it is also an elderly development containing all small one bedroom apartments which are not in high demand in the market. This limitation may influence the owner to stay in the LIHTC program. For these reasons, it was not included in the five properties most likely to leave the LIHTC program. North Warrenton Village is similar to River Terrace Apartments in that it is located in a low income county, with an approaching compliance end date and a for-profit owner, it does have a fifteen year qualified contract waiver.

Conclusions

The table below is a summary of the five properties most likely to seek exit from the LIHTC program. Each property shares some similar characteristics – compliance periods approaching their end, no project based financial assistance and for-profit ownership. One property is in a high income county where higher rents may be achieved through market conversion and the remaining four properties are in moderate and low income counties. Despite these eligibility factors, it is evident through this analysis of 1990 credit recipients that there will not be a drove of owners approaching the NCHFA for qualified contracts in the immediate future. And while these five properties represent potential units lost to qualified contracts, they represent only 11.8% of the 902 total units in the twenty nine projects. Three of the five properties – Fox Hollow, Vance County and Teamwork – have only 39 units between them. While these projects may be eligible to apply for a qualified contract, they are among the smallest developments in the NCHFA’s 1990 tax credit portfolio.

Table 4: 1990 Properties Most Likely to Seek Exit from the LIHTC Program – Summary Table

<table>
<thead>
<tr>
<th>1990 Properties</th>
<th>Compliance Period End Date</th>
<th>No. of Units</th>
<th>Project Based Financial Assistance</th>
<th>Ownership Type</th>
<th>County Income Level</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fox Hollow</td>
<td>2005 or 2006</td>
<td>10</td>
<td>No</td>
<td>For Profit</td>
<td>High</td>
</tr>
<tr>
<td>Teamwork for Housing</td>
<td>2005 or 2006</td>
<td>19</td>
<td>No</td>
<td>For Profit</td>
<td>Moderate</td>
</tr>
<tr>
<td>London Church Road</td>
<td>2005</td>
<td>26</td>
<td>No</td>
<td>For Profit</td>
<td>Moderate</td>
</tr>
<tr>
<td>Vance County</td>
<td>2005 or 2006</td>
<td>10</td>
<td>No</td>
<td>For Profit</td>
<td>Low</td>
</tr>
<tr>
<td>River Terrace</td>
<td>2005</td>
<td>42</td>
<td>No</td>
<td>For Profit</td>
<td>Low</td>
</tr>
</tbody>
</table>

A more immediate concern is the lack of extended use periods on some of the properties. While eight of the properties (26.6% of the twenty nine properties) are without a qualified contract waiver only four projects - Vance County, London Church Road, River Terrace and Ridley Street - would be eligible to leave the program after
the end of the compliance period because they are without additional affordability encumbrances, like Section 515 loans. These four projects contain 94 units, or 10.4% of the total units involved in this analysis. All these units would be able to exit the program at the conclusion of their compliance periods. \(^\text{11}\).

**Owner and Property Manager Interviews**

While the synthesis of eligibility and likelihood factors is important in determining which properties may request qualified contracts, it does not address the individual property issues that may dictate an owner’s exit strategy. Attempts were made to contact all twenty nine owners in order to determine plans for their respective properties. Nineteen of these twenty nine owners were successfully surveyed. A simple five question survey was conducted over the phone and by email (See Appendix B for survey questions).

The owner on record according to NCHFA documents was contacted first. In some cases, where the owner was neither available nor knowledgeable about the issues, the questions were addressed to the property manager. The issue of qualified contracts was not approached directly. It was assumed that if owners planned to pursue this option that it would be mentioned as an exit strategy. As such, a secondary purpose of this survey was to assess owners’ awareness of Y15 issues and the qualified contract process.

In only one case did an owner or property manager indicate that they were planning to sell the property. The decision of the other seventeen owners (another owner signified that he did not know what he would do with the property) to keep their properties operating as affordable was not dictated by altruism alone but by a variety of factors, many of which were detailed in the previous analysis. Some owners, while planning to keep the property affordable were actively looking to sell their interest to the general partner or sell it to a non profit entity. In other cases, owners indicated that they were planning to keep the property because no satisfactory exit strategy existed.

**Determinants in Maintaining Affordability**

In general, reasons for keeping a property affordable fell into seven categories. In many cases, owners or property managers listed more than one reason as a factor in their decision. These factors include:

- Non profit motive
- Rural Development loan
- Housing Voucher or Section 8 project based subsidies
- Well performing property – including low vacancy, adequate reserves, etc

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\(^{11}\) While the above analysis takes into account some basic factors that will undoubtedly influence an owner’s decision to request a qualified contract, there was neither scrutiny of submarkets nor evaluation of partnership agreements. Missing information also leads to some conjecture that may not be accurate.
• No satisfactory exit strategy
• Market and/or property conditions
• Extended affordability regulations

The following table details the number of responses that fell into each category.

Table 5: Factors Affecting Affordability

<table>
<thead>
<tr>
<th>Factors</th>
<th>Number of Responses</th>
<th>Percent of N</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non Profit Motive</td>
<td>2</td>
<td>6.7%</td>
</tr>
<tr>
<td>Rural Housing Loan</td>
<td>7</td>
<td>23.3%</td>
</tr>
<tr>
<td>Housing Voucher/Section 8</td>
<td>4</td>
<td>13.3%</td>
</tr>
<tr>
<td>Well Performing Property</td>
<td>4</td>
<td>13.3%</td>
</tr>
<tr>
<td>No Satisfactory Exit Strategy</td>
<td>3</td>
<td>10.0%</td>
</tr>
<tr>
<td>Market, Property Conditions</td>
<td>4</td>
<td>13.3%</td>
</tr>
<tr>
<td>Extended Affordability Regulations</td>
<td>6</td>
<td>20.0%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>N = 30</td>
</tr>
</tbody>
</table>

Rural Housing

In determining why a particular property would continue as affordable, the Rural Housing Section 515 loan and extended affordability restrictions constituted nearly 45% of the responses. Three out of the seven owners that listed the Rural Housing loan as a reason to keep their properties affordable indicated that it was not possible to get rent restrictions removed from the property until prepayment was allowed twenty years into the loan. Even at that point, meeting some of the prepayment hurdles would prove to be difficult.\(^\text{12}\)

It was determined previously that ten owners had Rural Housing loans financing their projects. Of those ten owners, seven were successfully interviewed. Six of the seven owners mentioned the 515 loan as a major factor in their decision to operate the property as affordable (only Currin Apartment owners failed to mention this as a reason). The additional property – River Terrace Apartments – indicated that the Rural Development loan was a determinant in their decision. However, NCHFA records do not reflect River Terrace as having a 515 loan.

Non Profit Motivation

While all five non profit providers, as indicated by NCHFA records, were successfully surveyed only two mentioned their mission as a contributing factor in their plans to keep their properties affordable. The other three non profits cited good operational

\(^{12}\) Congress has authorized the USDA, which administers the Rural Housing Loan program, to offer incentives so that prepayment can be avoided. However, there has not been enough funding allocated to meet incentive demands (Rapoza and Tietke, 3).
performance, Rural Housing 515 loans and Section 8 vouchers as influencing their
decision to manage their properties as affordable.

Extended Use Restrictions

Of the properties whose owners were successfully contacted, twelve of the nineteen
had extended use restrictions of eleven years or more. Five of the twelve (41.7%)
recognized this as a factor in their plans for the property. More interesting, however,
is the fact that this vital provision meant to maintain affordability for thirty years was
not mentioned by over half of the properties with extended use periods written into
their LURAs. In analyzing responses to the survey, it was apparent that this statute
is only one of many important factors affecting ownership decision making. The
following table is an attempt to explain the lack of reference to extended use
restrictions by these seven owners and property managers.

Table 6: Properties with Extended Use Restrictions that Did Not Mention This Factor in Future
Property Plans

<table>
<thead>
<tr>
<th>Properties</th>
<th>Ownership</th>
<th>Plans for Property</th>
<th>Factors Affecting Plans</th>
</tr>
</thead>
<tbody>
<tr>
<td>Seneca Woods</td>
<td>Non profit, Housing Authority</td>
<td>Retain Property and Keep affordable</td>
<td>- Well performing Property</td>
</tr>
<tr>
<td>Pungo Village</td>
<td>Non profit</td>
<td>Retain Property and Keep affordable</td>
<td>- Rural Housing Loan</td>
</tr>
<tr>
<td>Kent Street</td>
<td>Non profit</td>
<td>Retain Property and Keep affordable</td>
<td>- Section 8</td>
</tr>
<tr>
<td>Spencer Street</td>
<td>Non profit</td>
<td>Uncertain</td>
<td>- Non profit motive - Well performing property</td>
</tr>
<tr>
<td>Currin</td>
<td>For profit</td>
<td>Retain Property and Keep affordable</td>
<td>- Market, Property Conditions</td>
</tr>
<tr>
<td>Senior Village</td>
<td>For profit</td>
<td>Retain Property and Keep affordable</td>
<td>- Section 8 - Well performing property</td>
</tr>
<tr>
<td>Rockmoor</td>
<td>For profit</td>
<td>Retain Property and Keep affordable</td>
<td>- Rural Housing Loan</td>
</tr>
</tbody>
</table>

Six of the seven properties plan to keep their units affordable. This may be the
primary explanation on why emphasis was not placed on the use provisions during
the survey. Currin Apartments, owned by a non-profit, has not made plans. As a
non-profit its mission, while not stated as a factor, would certainly have influence
over its desire to keep the property affordable and therefore eliminate the extended
use restrictions as an overriding factor. In addition, the Currin Apartment
representative completing the survey indicated that there was continuing demand for
its product – affordable housing for the elderly.
Qualified Contracts

Throughout the course of the surveys, not one owner or property manager mentioned a qualified contract as a viable option. While not confirmed through any interviews, it is believed that lack of management and ownership familiarity with statute meaning and application contribute to the lack of knowledge regarding qualified contracts. Of the five properties - Fox Hollow Apartments, Teamwork for Housing, London Church Road, Vance County and River Terrace Apartments - listed as both eligible and likely to request qualified contracts only the owner of Vance County Housing could not be contacted. The owners of Fox Hollow Apartments, Teamwork for Housing and River Terrace Apartments all indicated that they planned to keep their properties affordable. The owner of London Church Road was the only respondent who mentioned his plans to sell the property after the compliance period concluded. He did not know when his property would be released from compliance restrictions.

The following table summarizes the responses of the five property owners whose projects were detailed in the previous section.

<table>
<thead>
<tr>
<th>1990 Properties</th>
<th>Plans</th>
<th>Factors in Decision</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fox Hollow Apartments</td>
<td>Retain Property and Keep affordable</td>
<td>▪ 30 year affordability period</td>
</tr>
<tr>
<td></td>
<td></td>
<td>▪ Market conditions</td>
</tr>
<tr>
<td>Teamwork for Housing</td>
<td>Retain Property and Keep affordable</td>
<td>▪ Extended affordability</td>
</tr>
<tr>
<td></td>
<td></td>
<td>▪ Property condition</td>
</tr>
<tr>
<td>London Church Road Apartments</td>
<td>Sell at end of compliance</td>
<td>▪ Market conditions</td>
</tr>
<tr>
<td>Vance County Housing</td>
<td>No Response</td>
<td>No Response</td>
</tr>
<tr>
<td>River Terrace Apartments</td>
<td>Retain Property and Keep affordable</td>
<td>▪ Rural Housing Loan</td>
</tr>
<tr>
<td></td>
<td></td>
<td>▪ Section 8 assistance</td>
</tr>
</tbody>
</table>

Based on NCHFA’s records on Fox Hollow Apartments, it was initially determined that its ownership status, lack of project based financial assistance, location in a high income county, and approaching compliance termination date made it a likely candidate for a qualified contract. In fact, it is eligible for ten separate qualified contracts since it received ten different tax credit allocations. The interview with the property manager of Fox Hollow – the same management company oversees operations of all the units – was indicative of conversations with many other owners. Making a decision to keep or sell the property, to try and retain affordability or go market rate was not simply a matter of tax credit statutes. Many factors are involved in the decision. With Fox Hollow, its location in a poor section of southeast Raleigh is as much of a factor in deciding to remain affordable as its extended use restrictions.
Surveys of owners and property managers, like the previous analysis, suggest that the NCHFA will not be receiving many qualified contracts within the next year. While the loss of affordable housing to the qualified contract process may not be an issue, preservation of existing housing seems to be a concern of some owners. Six of the nineteen owners and property managers (31.6%) indicated that upkeep – in the form of repairs and rehab – were recently done or needed to be done to keep the project viable. This number is likely to increase as these projects continue to age.

**The Exit and Preservation “Balancing Act”: Courses of Action**

At the core of the qualified contract process is the issue of how to allow limited partners to satisfactorily exit the program after gaining tax benefits while still maintaining the property as affordable. The qualified contract process promises to be an arduous and potentially adversarial ordeal, with high transaction costs. Therefore it should not, and in most cases will not, be the first step for owners seeking to sell their property. This concluding section will demonstrate that the post 1989 LIHTC stock can be preserved while allowing current owners to sell their projects and future owners to operate financially sound and attractive properties. The actions of the NCHFA, owners and municipalities are vital in helping to achieve this end.

_North Carolina Housing Finance Agency_

There are a number of actions that any housing finance agency should consider in trying to achieve its goal of creating affordable housing opportunities. These include set asides, loans, relaxed monitoring guidelines and preservation tax credits.

**Set Asides**

Even if the NCHFA can successfully navigate the unchartered qualified contract territory it will still have to deal with aging affordable properties. Most of the properties reaching the end of their fifteen year compliance period were designed to last fifteen years and now need an infusion of capital to meet ongoing needs. While all state agencies understand this issue, many are approaching it from different perspectives. Some state housing agencies, like the one in Michigan, have structured their QAP so that there are tax credits available just for expiring tax credit properties. In 2003, Michigan set aside 14% of their tax credits for this type of preservation program and has now increased that amount to 30% (Pitcoff; MSHDA 6). In fact, this set aside approach was the most significant factor in getting developers interested in preservation, which is approximately two-thirds of the cost of new construction (National Housing Trust 2).

Other states, like North Carolina, simply allow these properties to apply for the standard rehabilitation credits available to all applicants. However, in this situation, owners whose projects reach the end of the compliance period and who wish to resyndicate may encounter difficulties. While their properties are in need of repair, they may not exhibit as much need as older properties that have even greater
recapitalization requirements. This puts the property in the unenviable position of needing repairs but not being “old enough” to receive a credit allocation.

*Loans*

While the NCHFA has decided not to set aside credits, they realize that preservation will not happen without recapitalization and have set up a loan program that will help ensure long term affordability and financial solvency of tax credit properties. The $10 million dollar HOME funded Preservation Loan Program (PLP) allocates monies to qualified properties in need of repair and is now available to properties with placed in service dates on or before December 31, 1994.

This type of loan preservation loan program is being developed by other state housing agencies and by the secondary market. Freddie Mac has created a program to revamp aging Rural Housing Service Section 515 properties (Freddie Mac 341). This has the advantage of allowing affordable rural properties, which are often dependent on subsidies to operate, to make needed improvements while not saddling the owners with debt.

*Relaxed Monitoring Guidelines*

The NCHFA has developed other policies that help to promote retention in the LIHTC program and reduce the administrative burdens of the qualified contract process. Since the IRS is no longer involved in the monitoring of tax credit properties after the fifteen year compliance period, the NCHFA has developed a new monitoring policy that is less restrictive while still maintaining the integrity of the LIHTC program. For example, student status rules under Section 42 are now eliminated and unit transfers from building to building are allowed without triggering noncompliance regardless of whether a household’s income is over the applicable limit. Other states, like Ohio have taken a step further and reduced monitoring visits from three years to five years. These types of regulations in extended use compliance plans will hopefully provide incentive for owners to stay in the program and to forego the qualified contract process.

*Preservation Tax Credit*

Another less viable option that depends on the Congress is a new federal preservation tax credit. The proposal, first offered in 2003 as H.R 3485, would allow owners to claim a new preservation tax credit through the NCHFA if the owner sells the property to the NCHFA or a “preservation entity” that would agree to maintain

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13 Income eligible households comprised entirely of full time students are not eligible to occupy LIHTC units unless they meet certain exceptions. The Minnesota Housing Finance Agency Post-Y15 Monitoring Compliance policy eliminates this restriction. For mixed income properties, property managers must carefully monitor their tax credit units, making sure that they remain within the same building. Again, the MHFA policy would allow low income units to “float” from one building to another after Y15.
affordability and rent restrictions.\textsuperscript{14} The NCHFA would administer the program and have the right to allocate the credits if it deemed that the preservation entity’s plan for rehabilitation adequate for the entire preservation use period.\textsuperscript{15} The original bill was not clear on a number of issues. Any subsequent proposal in the future would need to deal with specific guidelines on allocation process, compliance and tax credit recapture. However, given the current political climate and ballooning budget deficits, this proposal is unlikely to be passed into law in the near future.

\textit{Owners/Investors}

When the changes to the tax credit program were instituted in 1989, little thought was given to exit strategies fifteen years into the future. Today, these issues involving partnership exit are garnering not only the interest of owners and investors but the attention of tax attorneys, accountants, the IRS, syndicators, and housing finance agencies.

At the center of the issue is the economics of the development and the nature of the early tax credit partnerships. These issues include:

- \textit{Economics outweighing tax considerations.} At the end of the fifteen year compliance period, the tax benefits have been realized. More than likely, cash flows have stabilized or even risen and residual value of the property has grown. The value of the property is now due to these cash flows and residuals, not the tax benefits. This process, which usually happens slowly through the holding period, may contribute to a significant tax for the investor once they leave the partnership. Cumulative tax losses and depreciation exceeding the equity investment lead to this exit tax by creating a negative capital account. Further complicating this situation is the fact that credits were purchased in the early days of the program for a fraction of their current selling price. This can lead to the accumulation of phantom income at a much earlier point in the life of the property. This leads to a second concern:

- \textit{The mismatch between ownership and control.} In the partnership, ownership is delegated to the limited partner investors while control is given to the general partner. This passive partnership relies on the sponsor to build, rent and stabilize the tax credit property, allowing the investor to receive their expected benefits (Smith and Pratt-Otto). As the end of the compliance period, and therefore the holding period, now comes to an end, this passive investment structure does not serve the investor well. Early tax credit partnership agreements took great care in separating limited partners from the daily decision making process so that they would not be considered as

\textsuperscript{14} The Affordable Housing Preservation Tax Relief Act of 2003, identified as H.R. 3485, “proposes to add a new section (42A) to the Internal Revenue Code under which an affordable housing preservation tax credit would be made available to facilitate the preservation of multifamily housing” (Duffley). Low-income housing tax credit properties (both 9% and 4% credits) would be among those eligible for assistance.

\textsuperscript{15} The preservation use period is defined as being no less than 30 years after the sale or until foreclosure occurs.
general partners. As the potential for passive losses (see Exit Tax Relief section below) increases and the benefits of ownership decrease, it is the general partner and not the owner who decides when or if to inaugurate a transaction. Keeping the status quo may benefit the sponsor who may increasingly enjoy the “upside” of the property, including its cash flows and control of its service and property management contracts (Smith and Pratt-Otto). If the investor, seeing the consequences of remaining vested in the property, wants to leave the partnership there is another barrier:

- Out-dated governing structure. Many early partnership deals were structured similar to corporate partnerships in that they required unanimity among partners when making property decisions or when changing governance structure (Duffley “Personal”). While this is no longer the case in more recent partnership agreements, earlier documents may make consent difficult to attain.

The key in overcoming these barriers is early communication between general partners, limited partners and syndicators around property performance, transaction opportunities, and governance reform. Favorable exit opportunities will center around these stakeholders developing a plan that includes review of capital accounts and disposition alternatives. This type of planning should begin in Year 11 with early intervention allowing for the effective implementation of plans should property operations and tax concerns become apparent (Brandenburg). General partners, working with the syndicator to provide evaluations of financial, physical and tax credit aspects of the property can help the transition to a non-profit sponsor who will provide for the long term affordability of the property (Del Rio 52).

Limiting Losses – Reviewing Capital Accounts Prior to Y15

If there is a potential to take on losses that exceed the equity contributed to the property then there are a number of alternatives for the partnership.

- Allocate tax losses away from the limited partner and give them to the general partner. This will usually require an amendment to the partnership agreement (Duffley “Personal”).

- Forgive debt which generates forgiveness of debt income.

- Capitalize rather than expense repairs.

- Improve operations by raising rents and reducing expenses.

Disposition Plans for Post Y15 – Contract Rights

Strategic planning between partners and syndicators must also include disposition arrangements. Again, there are a number of alternatives that would allow investors
to leave the partnership while still maintaining the viability and affordability of the property. The following options are open to investors by right of contract:

- **Right of first refusal by the non-profit sponsor.** This option is detailed in the IRC and allows a qualified non-profit organization, government agency or certain other tenant organizations to purchase the low income building for debt plus taxes (read exit taxes) resulting from the sale. Assuming that the property has been well operated, allowing the general partner to stay in the deal can provide greater stability for tenants through the extended affordability period (Del Rio 52). Because right of first refusal statutes do not dictate a length of time in which this option should be exercised, general and limited partners should negotiate a reasonable amount of time in which to conduct this transaction. If the right of first refusal is recorded in the deed records and is declined, then the nonprofit general partner should issue a quitclaim deed to clear title (Christensen 50).

- **Buyout of the investor by the general partner for fair market value.** This sale of interest in the partnership has no economic difference when compared to the right of first refusal. While options to acquire the limited partner interest at less than fair market value are not permitted by the IRS, calculating fair market value of an investor’s interest may offer opportunities to “reduce” value based on lack of marketability and/or control (53).

- **Qualified contract submission.** The reasons for this option have been sufficiently detailed in previous sections. Usually, owners who pursue this option will have exhausted other options and/or hope that no buyer can be found so that alternative, market rate property options can be pursued. Owners should understand that the NCHFA will allow only one request per project and thereby eliminate the possibility that owners will approach the Agency on multiple occasions trying to find the best deal.

**Disposition Plans for Post Y15 – Without Contract Rights**

The following alternatives are not detailed in a partnership agreement but are nonetheless available to owners. They include:

- **Complete a “bargain sale” by selling the property for a dollar over the mortgage and then donating the value greater than debt to a non-profit.** This would allow owners to take a tax deduction and offset any capital gains taxes.

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16 These do not represent all of the alternatives open to investors. There will certainly be new and creative exit strategies developed as Y15 approaches for more properties. Additional options may require a renegotiation of the partnership documents and include abandonment of investor interest, foreclosure, UPREIT transactions, trusts, and like-kind (1031) exchanges.

17 The actual wording in the IRC states that the minimum purchase price is an amount equal to the sum of (a) principal amount of outstanding indebtedness secured by the building (other than the amount of indebtedness incurred within the 5 year period ending on the date of the sale to tenants); and (b) all federal, state and local taxes attributable to the sale. Unsecured debt is not included as part of “outstanding indebtedness.”
This alternative can be especially attractive when it is used to offset taxes for an appreciated property (Brandenburg).

- Contribute interest in the property to a charity and realize a charitable contribution deduction either as an investor or as a partnership. In general, a charitable contribution of a capital gain property is deductible at its fair market value on the date of the contribution (Christensen 58).

- Sell to a third party with a predetermined split of any net sales proceeds between the investor and general partner. Since a majority of sale proceeds will generally be split according to ownership interest, general partners will want to carefully document all advances, loans and fees that is owed.

With many partnerships there will be room for creative deal making. For instance, the use of reserves, which are “owned” by the limited partners, may be used (given lenders’ permissions) to pay down the debt. Alternatively, the general partner may purchase reserves and personal property from the investors for one dollar. These actions may have some tax consequences and will need to be closely evaluated (Christensen 50). However, they can help ensure the viable operation of a property by the non-profit sponsor. Reserve accounts may also be used to pay off exit taxes or exit tax reserve accounts established to avoid future tax consequences for the investor.

**Exit Tax Relief**

As mentioned previously, a major concern of investors is exit taxes. While projections from one syndicator reveal that most properties have or will have positive capital accounts at their fifteenth year of compliance, where this is not the case, exit tax relief may help to strengthen affordable housing preservation (Brandenburg). Owners whose properties do not generate enough revenue to pay these taxes have limited exit options. If they are not able to pursue any of the strategies detailed above, then they will probably keep the property but not have the resources to recapitalize it. In assessing the impact of these taxes on rural housing owners, the Tax Issues and Preservation Task Forces of the Millennial Housing Commission estimated that if a tax incentive were created to allow exit tax relief at time of sale to an affordable housing preservation owner, as many as 68,000 Section 515 units could be preserved (Rapozza and Tietke 5).

**Municipalities**

There is a continued role for local governments and municipalities in helping to preserve the affordability of properties that are approaching the end of their compliance period and are now or will soon be eligible for qualified contracts. Local governments have provided grants and soft second mortgages to many LIHTC properties and must give approval (in many cases) if a general partner who purchases the owners’ share in the property wants to refinance mortgage debt or wants to receive debt forgiveness. This gives local governments extraordinary leverage in making sure that local housing priorities are met.
Collaborating and Strengthening Non-Profits

While non-profit developers and organizations will have a great interest in preserving the affordability of properties, stakeholders – including the NCHFA, developers, syndicators, and consultants - have cited a lack of capacity among non-profits that will prevent them from being significant actors in Y15. While the sector has grown in experience and ability – non-profits currently sponsor 17% of all projects and 25% of all units – it will need the support of local governments in order to preserve the viability of the LIHTC properties (Christian 5).

Local governments must work with non-profit developers and general partners who have interest in keeping properties affordable. As mentioned in the previous section, non-profit housing organizations have the potential to act as preservation entities and are likely to get favorable purchase terms for the LIHTC properties. In order to facilitate this type of transfer from an owner to non-profit, local government officials should be encouraging the negotiation of provisions in partnership agreements so that non-profits have ample time to purchase the property after 15 years.

Loans and Grants

Municipalities will also need to make loans and grants available for capital improvements to these properties. In order to support this effort, municipalities should support increased flexibility in the dispersement of HOME funds so that they can be used in conjunction with the preservation needs of LIHTC properties (Millennial Housing Commission 64).

Conclusion

The LIHTC program has produced over 1.6 million units of affordable rental housing since its inception in 1986 (Hobbs). When the program was reformed in 1989, an extended affordability clause required all projects receiving tax credits after 1990 to retain affordability and remain rent restricted for a minimum of thirty years. As part of these reforms, Congress included a way for owners to try and opt out of the program after gaining the benefits of the tax credits. For owners who want to sell their properties after the fifteen year compliance period a sales provision, known as the qualified contract in Section 42 of the Internal Revenue Code (IRC), was introduced. If the housing finance agency cannot find a buyer, then the owner is free to convert the property to a market rate use after a three year vacancy decontrol period. The requirements needed to fulfill the qualified contract provisions are now being codified by housing finance agencies all over the country. The process will undoubtedly be a difficult one with high transaction costs.

In an effort to substantiate both the eligibility and likelihood of property owners applying for a qualified contract, property evaluations of North Carolina’s 1990 tax credit properties and personal interviews of owners and property managers of these projects were completed. Properties were evaluated to the extent that they had:

IRC Section 42 allows for eligible non profits to purchase LIHTC properties at the end of the fifteen year compliance period for outstanding debt and all federal, state and local taxes.
• no project based financial assistance
• for-profit ownership
• compliance periods ending in 2004 or 2005
• location in a high income county

Only one property - Fox Hollow Apartments in Wake County – met all four criteria. Teamwork for Housing, London Church Road Apartments, Vance County Housing, and River Terrace Apartments met three of the four criteria, with the exception being their location in middle and low income counties.

Seventeen of the nineteen owners and property managers who were successfully contacted indicated that they planned to retain ownership of their properties and keep them affordable. These decisions were not based on tax credit statutes alone. Many factors – including non-profit motives, project based financial assistance, well performing properties, market location and property conditions - are involved in the decision.

This assessment of 1990 tax credit properties revealed that the North Carolina Housing Finance Agency (NCHFA) will not get an influx of owners seeking qualified contracts. This does not mean that affordable rental housing preservation is not an issue. After owners receive their tax benefits, most will want to sell the property or their ownership interest. At this point, long term project viability will be an important issue as aging properties will need to be recapitalized in order to remain healthy and attractive places to live. The NCHFA, investor/owners, and municipalities each have roles to play in preserving and transferring properties to affordable housing providers. These avenues can be pursued within each actor's resource limitations and investment interests.
Acknowledgements

Mark Shelburne and Betty Ballentine of the North Carolina Housing Finance Agency were instrumental in providing guidance and direction for this project.

Greg Mayo of the Community Affordable Housing Equity Corporation (CAHEC) and Peter Duffley of Womble, Carlyle, Sandridge and Rice, PLLC also offered helpful advice and insights into the Courses of Action section of the paper.
Appendix A

Information that would assist in the evaluation of the 1990 projects was gathered from the Rental Compliance Reporting System (RCRS) and the tax credit monitoring files that are maintained by the Asset Management staff at NCHFA.

The following information gathered from these sources includes:

- Ownership entity and names of partners according to the original tax credit application
- Ownership entity contact information according to the most recent “Owner’s Certification of Continuing Program Compliance”
- Financing arrangements according to the original application
- Project Based Rental Assistance according to LIHTC Project Monitoring forms
- Violations as reported on IRS Form 8823
- Placed in service date, multi-building project information, allocation type, and beginning credit year from IRS Form 8609
- Mixed Income information from LIHTC Project Monitoring forms
- Extended Use Agreements as detailed in Land Use Restrictive Agreement (LURA)
- Owner information as recorded in the Rental Compliance Reporting System (RCRS)
- Income Level designations detailed in the 2004 Qualified Allocation Plan (QAP)

The above information was collected and organized into a database (NCHFA Properties) for inquiry and evaluation purposes.
Appendix B

1) You’ve been operating the property for about 15 years. What are your plans? (IF KEEPING PROPERTY SKIP QUESTION #2).

2) Do you have an exit strategy for your property? If so, what is it?

3) What factors are/were important to you in making this decision to either keep or not keep the property?

4) Looking back, what has your experience been with the development? Why? Please comment on things like vacancy, property management, reserves, reporting requirements, etc.

Please Rate your experience with this particular development on a scale of 1 to 5, with one being poor and five being excellent

1  2  3  4  5

5) What has been your experience with the tax credit program? Please comment on your relationship with the NCHFA and if you have invested again through the LIHTC program.

Please Rate your experience with the tax credit program on a scale of 1 to 5, with one being poor and five being excellent

1  2  3  4  5

Many Section 515 rural housing developments need reinvestment. Freddie Mac is now developing underwriting criteria as well as plans that will require lenders and the Rural Housing Service to meet with an owner and come up with a plan of action to determine the amount of capital a project needs and how much it can afford. This could be a potential source of funds for recapitalizing early LIHTC properties that received Section 515 assistance.


This website contains presentations from a September 29, 2004 National Association of Home Builders Housing Credit Group forum. Included in the presentations are details about pricing qualified contracts, Y15 administrative issues, and equity take out refinancing.


IRC Section 42, the low income housing tax credit law that provides qualified contract definitions and procedures.


The author describes Minnesota’s post year 15 compliance monitoring plan when the IRS will no longer monitor tax credit properties for non-compliance.


The NLIHC provides a comprehensive nationwide analysis on the lack of affordable housing. The report includes county by county statistics on housing wages and average rents.


The article provides an overview of the Ohio Housing Finance Agency’s relaxed monitoring standards for the extended use period. For example, the agency will waive its requirements for an annual recertification of tenant income but will continue to require full income certifications and third party verifications upon move in.

This article examines expiration restrictions. There are also recommendations regarding changes to the LIHTC program that could help preserve the affordable housing stock.

"Rising Construction, Operating Costs May Jeopardize Project Feasibility." Housing and Development Report 32.CD-14 (2004): 430-31. This article discusses the problems of rising construction and operating costs that are affecting preservation projects in many states, especially the early tax credit projects.


"Washington Develops Procedures to Facilitate Owner Sale." Tax Credit Advisor July 2004 (2004): 1, 8-9. The Washington State Housing Finance Commission was the first to develop procedures for handling qualified contract requests. This article details some of those procedures and includes comments from staff, who provide some reasoning behind their initiative.


Beesemyer, Paul and Falk, Janet. The Tax Credit Turns Fifteen: Conversion Risk in California's Early Tax Credit Portfolio. San Francisco, CA: California Housing Partnership Corporation, 2001. A detailed examination of the expiring affordability requirements, the characteristics and conversion risk of California’s early tax credit stock, and the potential impacts of conversion upon thousands of California’s seniors, disabled, working poor, and formerly homeless.


are most likely to use in handling qualified contract requests. Breed reviews potential staffing needs for housing finance agencies and qualified contract submission costs and fees for owners.

Tax attorney Jerry Breed raises questions regarding the calculation of the qualified contracts for post-1989 tax credit properties. The article details many of the IRC Section 42 issues the IRS has not addressed.


Christian, Colin C. “Reservations about Preservation: Year 15 and the Low Income Housing Tax Credit Program in North Carolina.” The University of North Carolina at Chapel Hill, Public Administration. 2003. This paper examines the role of the North Carolina Housing Finance Agency, which administers the state’s tax credit program, in helping to preserve tax credit properties beyond Year 15 and the public policy issues this involves.


Duffley, Peter. Personal Interview. 7 April 2005.

This article explains how the Year 15 issue will affect investors and how to reduce the amount of exit taxes before selling the property.

A brief question and answer surrounding the ESIC properties reaching the end of their compliance period.

An overview of the concerns that all parties have in underwriting LIHTC deals, including interests of lenders, equity investors, and municipalities.


This paper contains a thorough analysis of Georgia's tax credit portfolio addressing legal issues and categorizing those properties at risk of turning to market. The author also makes some recommendations on preservation.

An early report addressing concerns raised around the potential loss of affordability of 1990 tax credit projects. Author addresses primary challenges in keeping properties affordable as well as the compliance monitoring for properties that remain affordable after the 15 year compliance period.

Members of the National Association of Home Builders Tax Credit Group contribute perspectives on dispositions which include sale (to unrelated third parties), transfer (to general partners), refinancing, resyndication and limited equity transfers


Joint Center for Housing Studies of Harvard University, The. Expiring Affordability of

Khadduri, Jill, Burnett, Kimberly and Rhoda, David. Targeting Housing Production Subsidies: Literature Review. Cambridge, MA: Abt Associates, 2003. An in-depth look at the current academic literature regarding housing production subsidies. Based on the literature review, authors give guidance as to when production subsidies may be more useful than demand subsidies in providing affordable housing.


McClure, Kirk. "The Low-Income Housing Tax Credit as an Aid to Housing Finance: How Well Has It Worked?" Housing Policy Debate 11.1 (2000): 91-114. McClure provides an overview, levels criticism and offers recommendations for the LIHTC program. Two criticisms include the program's inability to serve poor families in metro areas where the rents are too high and the inefficiency of the subsidy delivery mechanism. The author recommends giving more funding flexibility to state agencies so that higher credit amounts can go to more worthy projects and have the effect of reducing developers' need to chase after additional layers of subsidy.


National Council of State Housing Agencies. NCSHA Year 15 Questionnaire: Summary of Responses. Washington, DC: National Council of State Housing
A summary of responses gathered by the NCSHA regarding the post year 15 preservation policies of state housing agencies.

This report details successful initiatives of state housing finance agencies in preserving their affordable housing stock. Successful programs incorporate set asides and an array of preservation options.

Among other issues, the author focuses on nonfederal solutions that can increase the affordable housing supply while requiring little or no subsidies.


A look into the recapitalization and rehabilitation issues of the year 15 properties.

With preservation credits on the horizon for post 1989 properties, this article looks at the effects of new income limits on properties that get new credits. The author argues that tenants who no longer meet income limits under the old criteria should be grandfathered in so that they will not be forced to vacate.

The authors provide recommendations for the improvement of rural affordable housing programs with special consideration given to the USDA’s Section 515 program.


---. “Thinking About Year 15 of a Low Income Housing Credit Partnership (Part 2).” Property Compliance Report. September (2001): 1-2. The author continues his analysis of the difference between a right of first refusal and an option. There is further advice on how to handle a right of first refusal agreement as well as insights into qualified contract regulations.


Zastrow, Jane. "Despite Pending Expiration, Year 15 Properties Still Hold Potential."