CAPITAL ACCOUNTS & IMPACT ON DISPOSITIONS

NH&RA Summer Institute

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centerline capital group

INVESTOR/SYNDICATOR Y-15 GOALS

- Close funds soon after year 15.
- NOI and value are established…15 years of history.
- When no TC benefits, Corporate Inv. do not want losses.
- Mitigate recapture risk and other liabilities.
- Syndicator has more experience creating value, must drive the disposition process.
- **Maximize residual value…**
  - **1. know your Real Estate Value.**
  - **2. Know your documents**
  - **3. Know your Accounting…Capital Accounts**

ANALYSIS DRIVES THE STRATEGY AND THE NEGOTIATIONS…

» Ask the questions:

- » **What's the market?**
  …Significant changes in Property and Investment Markets
- » **What's possible?**
  …Where are the 4% executions? Wait for the elusive 9%?
- » **What's the Highest and Best Value?**
  …Will continue to change w/pent-up investment demand

Use a detailed, disciplined Valuation Model.

VALUATION SUMMARY

Property Valuation Summary

SCENARIO	Property Value	Price Per Unit	LP Proceeds (Waterfall)	LP Proceeds (Capital Account)	GP Proceeds (Waterfall)	GP Proceeds (Capital Account)
Market Value (w/ restrictions)	2,009,935	31,405	1,471,908	1,074,414	-	397,443
4% Resyndication	1,240,138	19,377	717,502	600,454	-	117,048
9% Resyndication	2,112,948	33,015	1,572,856	1,124,880	-	447,919
ROFR Price	483,455	7,554	-	-	-	-
Option Price	3,147,845	49,185	2,587,055	1,631,879	-	955,019
Qualified Contract Price	4,766,116	74,471				
Market Value (w/o restrictions)	3,147,845	49,185	2,587,055	1,631,879	-	955,019
LP Cash Flow Multiple			33,310	33,310		
Refinance Scenario			1,130,953		-	
CONCLUDED SALE VALUE	**2,000,000**	**31,250**	**1,462,167**	**1,069,547**	**-**	**392,574**
Accrued SLP Fees & Proceeds			28,000	28,046		
TOTAL TO LPs	.		**1,490,167**	**1,097,593**		

Capitalization Rate Analysis

	Amount	Rate
2011 NOI	9,504	0.5%
Avg 5 Yr NOI	37,333	1.9%

Comments

OPTION/ROFR & RESTRICTIONS

Option Agreement and Right of First Refusal (ROFR)

Market Value - Unrestricted	3,147,845
Debt Plus Taxes	483,455
LP Purchase Price - Exit Taxes	-

Option Price	3,147,845
ROFR Price	483,455

Debt Plus Taxes Calculation	
Outstanding Debt	483,455
LP Capital Account	-
Tax liability @35%	-
Gross up	-
Transfer Tax	-

Does Partnership have an Option Agreement? Yes

Option Price (Select One)

- Greater of Market Value or Debt Plus Taxes
- Market Value
- Other

If "Other", enter Option Price

Does Partnership have a ROFR? Yes

ROFR Price (Select One)

- Debt plus taxes
- Market Value
- Other

If "Other", enter ROFR Price

Summarize document(s) and specific location of provisions, including term, purchase price, and notice provisions

Option and Right of First Refusal Agreement (10/18/1995): The grantee is XYZ and has an 4-year option to purchase the property at the end of the compliance period. In the event there is a bona fide offer, XYZ has right of first refusal to purchase the property.

PRO FORMA REVIEW

		Historical Audit			Quarterly Financials (Centerline)						Pro Forma - Restricted	
		2011	per unit		TTM Q3-2011	per unit		Annualized Q3-2011	per unit		2012	per unit
Operating Income												
Gross Rental Income		561,733			558,363			565,412			661,251	
Vacancy	14%	(79,895)		16%	(87,760)		15%	(83,493)		5%	(33,063)	
Bad Debt and Concessions	1%	(7,468)		0%	-		0%	-		1%	(6,613)	
Other Income		16,090	251		10,999	172		6,225	97		16,090	251
Total Income		**490,460**			**481,602**			**488,144**			**637,666**	
Operating Expenses												
Management Fee	0%	-	-	0%	-	-	0%	-	-	4%	25,507	399
Admin/Misc		111,649	1,745		107,646	1,682		114,969	1,796		99,742	1,558
Utilities		42,959	671		43,675	682		43,659	682		39,338	615
Maint		150,659	2,354		205,216	3,207		170,267	2,660		182,048	2,845
Payroll		118,585	1,853		52,414	819		76,668	1,198		74,276	1,161
RE Taxes		-	-		-	-		-	-		-	-
Insurance		26,925	421		21,020	328		31,909	499		29,422	460
Marketing		-	-		-	-		-	-		-	-
Land Lease		17,388	272		17,388	272		17,388	272		17,388	272
Total Operating Expenses		**468,164**	**7,315**		**447,359**	**6,990**		**454,860**	**7,107**		**467,721**	**7,308**
Less: Replacement Reserve Deposits		12,792	200		12,792	200		12,792	200		19,200	300
Net Operating Income		**9,504**			**21,451**			**20,492**			**150,745**	
Hard Debt Service		(3,864)										
DSCR		2.46										
Net Cash Flow		5,640										

Comments

No hard debt. **No management fee - GP provides management services without compensation. Estimated Proforma income and expenses to match consultant's 2012 proforma** - except included management fee at 4%. Assumes utility expenses decreases due to green redevelopment plan.

PRO FORMA REVIEW – CONTINUED…

Unit Mix and Rental Income

# BRs	# Units	Sq Ft Per Unit	Current AMI % Set Aside	Current Rent 1/17/12	Utility Allowance a/0 1/31/12	Max TC Rent	Unrestr. Market Rent	Pro Forma Rent
Efficiency/Studio	2	300 - 454	60%	350	0	1,129	700	385
JR1BA/1BA	2	500	60%	633	0	1,209	870	696
1BA/1BA Flat	13	478	60%	636	0	1,209	800	699
1BA/1BA	1	585	60%	400	0	1,209	825	440
1BA/1BA Den	6	725	60%	795	0	1,209	900	874
2BA/1BA Flat	9	577	60%	862	209	1,243	850	948
2BA/1BA Den	20	767	60%	824	209	1,243	970	907
2BA/1BA	2	800	60%	975	209	1,243	1,000	1,073
3x1 TH	8	833	60%	952	250	1,427	1,070	1,047
4TH	1	1,000	60%	890	297	1,573	1,125	979
	64	655		783	137	1,256	914	861

** Current rents includes excess S8 rents.*

Section 8 Status

Section 8 Contract?	No
Units (unit mix above)	
Contract expiration date	

Historic Operations

	Last 5 Yr Avg	2011	2010	2009	2008	2007
Per Audits						
Rent (EGI)	467,786	490,460	436,010	426,670	489,395	496,396
Expenses	(419,367)	(468,164)	(412,278)	(399,377)	(445,824)	(371,190)
RR Deps	(11,086)	(12,792)	(8,528)	(8,528)	(12,792)	(12,792)
NOI	37,333	9,504	15,204	18,765	30,779	112,414
Debt Service	(40,490)	(3,864)	(42,980)	(50,367)	(51,581)	(53,657)
Cash Flow	(3,157)	5,640	(27,776)	(31,602)	(20,802)	58,757

5 Yr Rent Growth -1.19%
5 Yr Expense Growth +26%
5 Yr NOI Growth -91%

VALUATION ANALYSIS (INCLUDING 4% AND 9% EXECUTION)

Market Value and Qualified Contract

Market Value (w/restrictions)

Pro Forma NOI		150,745
Cap Rate	7.5	2,009,935
Less: Extraordinary Capital Needs		
Total Property Value		**2,009,935**

Qualified Contract Price

Net Equity to Partnership	2,994,868
Outstanding Debt	483,455
COLA Adjustment	143%
Distributions	-
Qualified Contract Price	**4,766,116**

Market Value (unrestricted)

Pro Forma NOI		236,088
Cap Rate	7.5	3,147,845
Less: Extraordinary Capital Needs		
Total Property Value		**3,147,845**

Reysndication

4% Resyndication

SOURCES			
Mortgage	82%	1,929,538	30,149
Equity (4%)		1,367,000	21,359
State TC Equity			
New Soft		700,000	10,938
Soft		-	-
Deferred Dev Fee		-	-
Total Sources		3,996,538	62,446
Debt forgiveness	-		
Rollover of soft	-		
USES			
Acquisition		1,240,138	19,377
Hard Const	Min=$3,875	1,536,000	24,000
Soft		640,000	10,000
Developer Fee		388,400	6,069
Reserves		192,000	3,000
Total Uses		3,996,538	62,446

Property Purchase Price	**1,240,138**
Post-recycle CF	**45,224**
Bond Allocating Agency:	DCHFA
Application Deadline	Not Available

4% Credits

Acq. Basis
1,381,136
Rehab Basis
3,150,422
Annual credits
145,463

Calc 4% S&U

Appraised Property Value
2,009,935

9% Resyndication

SOURCES			
Mortgage	100%	1,607,948	25,124
Equity (9%)		3,305,000	51,641
State TC Equity			
New Soft		-	
Assumed Soft		-	-
Def Fee		-	-
Total Sources		4,912,948	76,765
Debt forgiveness	-		
Rollover of soft	-		
USES			
Acquisition		2,112,948	33,015
Hard Const		1,536,000	24,000
Soft		640,000	10,000
Dev Fee		432,000	6,750
Reserves		192,000	3,000
Total Uses		4,912,948	76,765

Purchase Price	**2,112,948**
Post-recycle CF	**22,612**
LIHTC Allocating Agency:	DCHFA
Application Deadline	Not Available

9% Credits

Acq. Basis
2,222,760
Rehab Basis
3,113,728
Annual credits
351,586

Calc 9% S&U

Financing Assumptions for Resyndication

Tax credits

		Credit Rates	
DDA	No	as of	May-12
QCT	Yes	4%	3.21%
Other Basis Boost	No	9%	9.00%
Developer fee		Price/credit	0.94
Acquisition	5%	Rehab/unit	24,000
Rehab	15%	Soft/unit	10,000
		Reserves/unit	3,000

Tax-exempt bonds

Rate	4.25%
Term	30
DSC	1.30
LTV Limit	80%

Taxable financing

Rate	4.75%
Term	30
DSC	1.15
LTV Limit	80%

* Current loan underwriting standards are conservative, resulting in lower refinance proceeds and higher future cash flow

LP CASH FLOW MULTIPLE AND REFINANCE ANALYSIS

Refinance scenario

Sources			**Debt Terms (from Valuation Tab)**		
Supportable Debt*		1,607,948	Rate		4.75%
Less financing costs	2%	(32,159)	Term		30
Gross Financing Proceeds		1,575,789	DSC		**1.15**
Less capital needs		-			
Cash and reserves		66,619	LTV Limit		**80%**
Total Sources		1,642,408			
Uses			**Valuation**		
Prepayment penalty		-	Pro Forma NOI		150,745
Payoff mortgages		483,455	Value		2,009,935
			Cap Rate		7.5%
Refi Proceeds		**1,158,953**			
			LTV Limit		1,607,948
Distribution of Refinancing Proceeds					
Distributions - LP		1,130,953	New Debt Service		(100,654)
Distributions - GP		-			
Distributions - SLP		28,000	Refi Cash Flow		150,745

LP Cash Flow Multiple

Pro Forma Cash Flow		50,091	**Value of Cash Flow**		
LP Portion of CF		-	Cash flow multiple		6.7
see Cash Flow Waterfall for details			Cash on cash yield		15%
Value of cash flow (6.7x mult)		-			
P'ship Assets (excl. Sec. Dep.)	50%	33,310	**Value of Losses**		
Value of losses (0.0x mult, 35% tax rate)		-	Losses mulitple		-
			LP tax rate		35%
Total LP Value AS-IS		**33,310**	*Assumption: 35% tax rate for corporate funds, 33% for public funds*		

CAPITAL GAIN ANALYSIS

Gain (Loss) on Sale

Purchase Price	2,009,935
Less Cost of Sale	(70,199)
Book value of assets	2,357,330
Decrease until Sale	(54,982)
Gain (loss) on Sale	(362,612)

Section 9.1.B

Allocate (to the extent possible) in accordance with 9.2?

No

Capital Accounts - Post Sale

LP Capital Account as of 12/31/11	1,607,445	
Increase/decrease until Sale *	(48,600)	
LP Capital Account Prior to Sale	1,558,845	
Allocation of Gain	(717,899)	
Priority Distribution		
LP Capital Account After Sale	840,946	84%
GP Capital Account as of 12/31/11	171,671	
Increase/decrease until Sale *	(491)	
Contribution to payment of Developer Fee	-	
GP Capital Account Prior to Sale	171,180	
Allocation of Gain	(7,252)	
Priority Distribution		
GP Capital Account After Sale	163,928	16%
SLP Capital Account as of 12/31/11	(139)	
Increase/decrease until Sale *	(5)	
SLP Capital Account Prior to Sale	(144)	
Allocation of Gain	(73)	
Priority Distribution		
SLP Capital Account After Sale	(217)	0%
Co-GP Capital Account as of 12/31/11	-	
Increase/decrease until Sale *	-	
Co-GP Capital Account Prior to Sale	-	
Allocation of Gain	-	
Priority Distribution		
Co-GP Capital Account After Sale	-	0%

PARTNERSHIP SALES TABLE

Distribution of Proceeds (Waterfall)

	Partnership Net								Residual Splits			Totals		
									49.99%	0.01%	50.00%			
Property Purchase Price	Cash and Reserves	3rd Party A/P	Transaction expenses	Gross Sales Proceeds	Repayment of debt and obligations due upon sale, other than amounts to Partners	SLP Fees	To LP, its Investor Contributions	Unpaid balance of Voluntary Loan	LP	SLP	GP	LP	SLP	GP
2,000,000	66,619	(22,997)	(70,000)	1,973,622	483,455	30,000	1,460,167	-	0	0	0	**1,460,167**	**30,000**	**-**
2,250,000	66,619	(22,997)	(75,000)	2,218,622	483,455	30,000	1,705,167	-	0	0	0	**1,705,167**	**30,000**	**-**
2,500,000	66,619	(22,997)	(80,000)	2,463,622	483,455	30,000	1,950,167	-	0	0	0	**1,950,167**	**30,000**	**-**
2,750,000	66,619	(22,997)	(85,000)	2,708,622	483,455	30,000	2,195,167	-	0	0	0	**2,195,167**	**30,000**	**-**
3,000,000	66,619	(22,997)	(90,000)	2,953,622	483,455	30,000	2,440,167	-	0	0	0	**2,440,167**	**30,000**	**-**
3,250,000	66,619	(22,997)	(95,000)	3,198,622	483,455	30,000	2,685,167	-	0	0	0	**2,685,167**	**30,000**	**-**
3,500,000	66,619	(22,997)	(100,000)	3,443,622	483,455	30,000	2,930,167	-	0	0	0	**2,930,167**	**30,000**	**-**
3,750,000	66,619	(22,997)	(105,000)	3,688,622	483,455	30,000	3,175,167	-	0	0	0	**3,175,167**	**30,000**	**-**
4,000,000	66,619	(22,997)	(110,000)	3,933,622	483,455	30,000	3,420,167	-	0	0	0	**3,420,167**	**30,000**	**-**
4,250,000	66,619	(22,997)	(115,000)	4,178,622	483,455	30,000	3,502,770	49,201	56,586	11	56,597	**3,559,356**	**30,012**	**105,799**
4,500,000	66,619	(22,997)	(120,000)	4,423,622	483,455	30,000	3,502,770	49,201	179,061	36	179,097	**3,681,831**	**30,037**	**228,299**
4,750,000	66,619	(22,997)	(125,000)	4,668,622	483,455	30,000	3,502,770	49,201	301,537	60	301,597	**3,804,307**	**30,061**	**350,799**
5,000,000	66,619	(22,997)	(130,000)	4,913,622	483,455	30,000	3,502,770	49,201	424,012	85	424,097	**3,926,782**	**30,086**	**473,299**

PARTNERSHIP SALES TABLE

Distribution Upon Liquidation of Partnership (Capital Accounts)

	Partnership Net							Capital Account Splits			Residual Splits			Totals		
								840,946	-	163,928	49.99%	0.01%	50.00%			
Property Purchase Price	Cash and Reserves	3rd Party A/P	Transaction expenses	Gross Sales Proceeds	Repayment of debt and obligations due upon sale, other than amounts to Partners	SLP Fees	Unpaid balance of Voluntary Loan	LP	SLP	GP	LP	SLP	GP	LP	SLP	GP
2,000,000	66,619	(22,997)	(70,000)	1,973,622	483,455	30,000	49,201	840,946	0	163,928	203,005	41	203,046	1,043,952	30,041	416,175
2,250,000	66,619	(22,997)	(75,000)	2,218,622	483,455	30,000	49,201	840,946	0	163,928	325,481	65	325,546	1,166,427	30,065	538,675
2,500,000	66,619	(22,997)	(80,000)	2,463,622	483,455	30,000	49,201	840,946	0	163,928	447,956	90	448,046	1,288,903	30,090	661,175
2,750,000	66,619	(22,997)	(85,000)	2,708,622	483,455	30,000	49,201	840,946	0	163,928	570,432	114	570,546	1,411,378	30,114	783,675
3,000,000	66,619	(22,997)	(90,000)	2,953,622	483,455	30,000	49,201	840,946	0	163,928	692,907	139	693,046	1,533,854	30,139	906,175
3,250,000	66,619	(22,997)	(95,000)	3,198,622	483,455	30,000	49,201	840,946	0	163,928	815,383	163	815,546	1,656,329	30,163	1,028,675
3,500,000	66,619	(22,997)	(100,000)	3,443,622	483,455	30,000	49,201	840,946	0	163,928	937,858	188	938,046	1,778,805	30,188	1,151,175
3,750,000	66,619	(22,997)	(105,000)	3,688,622	483,455	30,000	49,201	840,946	0	163,928	1,060,334	212	1,060,546	1,901,280	30,212	1,273,675
4,000,000	66,619	(22,997)	(110,000)	3,933,622	483,455	30,000	49,201	840,946	0	163,928	1,182,809	237	1,183,046	2,023,756	30,237	1,396,175
4,250,000	66,619	(22,997)	(115,000)	4,178,622	483,455	30,000	49,201	840,946	0	163,928	1,305,285	261	1,305,546	2,146,231	30,261	1,518,675
4,500,000	66,619	(22,997)	(120,000)	4,423,622	483,455	30,000	49,201	840,946	0	163,928	1,427,760	286	1,428,046	2,268,707	30,286	1,641,175
4,750,000	66,619	(22,997)	(125,000)	4,668,622	483,455	30,000	49,201	840,946	0	163,928	1,550,236	310	1,550,546	2,391,182	30,310	1,763,675
5,000,000	66,619	(22,997)	(130,000)	4,913,622	483,455	30,000	49,201	840,946	0	163,928	1,672,711	335	1,673,046	2,513,658	30,335	1,886,175

Typical Adjustments to Capital Accounts

Additions	Subtractions
• Capital Contributions • FMV of property contributed	• Distributions/Capital Withdrawals • Property distributed to partners
• Allocation of Partnership Income and Gain	• Allocation of Partnership Losses and deductions

No Impact
• Tax Credits • Fees paid to owners (e.g. Developer Fee, Supervisory Management Fee)

Beware the Books
• Tax vs GAAP both have capital accounts • BUT could be different due to : depreciation, accruals, related party deals. • IRS Rules (TAX) vs FASB Rules (GAAP)

Two LIHTC Capital Account Issues:

- **1. CAPITAL ACCOUNTS CAN JEOPARDIZE INVESTORS' ABILITY TO CLAIM CREDITS.**
  - Credits follow losses…When the LP cannot claim losses cannot claim Credits
  - Need positive capital account basis to claim losses
  - If capital account reaches zero, you need some accounting tricks:
    - Minimum gain, disaffiliate deferred developer fee DRO

- **2. THE DISPOSITION ISSUE:**
  - **CAPITAL ACCOUNTS CAN CHANGE THE RESIDUAL SPLITS**

When is a waterfall not a waterfall?

- **P A says: Waterfalls govern cash splits of a sale   BUT**
- **IRS says** that liquidation allocations be made in accordance with the positive capital account balances of the partners.
- **Therefore: §9.2.B (Proceeds from Sale or Refinance) is subject to §12.4 (Liquidation)**
- **§12.4 says on liquidation:**
  - After payment of Liabilities BUT before the final splits,
  - Balance of PA assets of the Partnership shall be distributed according Partners' capital account balances.
  - Determined AFTER all allocations for the year during which the liquidation occurred have been made.
- Must calculate LP capital account after sale of property and allocation of all "book profits" from sale

We are Rich! But… GP or LP $???

1996 **Spiney Orchards, LP Invested $1.5M capital in new construction, 80/20, 258 units.**

2012 Property Value, $37M - $17M debt = $20 MM PROCEEDS

- **Waterfall: (9.2.B) <u>Return</u> Capital, then 80/20 split(GP/ LP)**
  - **LP gets: 1.5 capital + 20% (balance 18.5M) = $5.2 M**
  - **GP gets: 20MM – 5 .2MM (paid to LP)   = $14.8 M**
- **Capital Accounts: (9.1 A) <u>Restore</u> CA, then 50/50 split**

  37 MM profit – 14 BV = 23MM Book Profit
  - **LP CA is – 5 M add sale gain 14.5M +1.0M = $10.5M**
  - **GP CA is   0   add sale gain   8.5M +1.0M = $9.5M**

The Financial Result

- **Waterfall**:

  LP $ 5.2 MM (25%)

  GP $14.8 MM (75%)

- **Capital Accounts:**

  $10.5 MM (53%)

  $9.5 MM (47%)

Final settlement:

Negotiated sale of interests for 7.5 M (5X original 1.5M equity)

The Practical Result: Everyone is unhappy

- **Investor: Likes Capital Accounts…feels they gave up $3.0MM**
- **Developer: Likes Waterfalls… feels he gave up $3.3MM**
- **Syndicator: Likes living…feels they both may try to kill him.**

MORAL:

Accountants are the reason we are not happy in life.

www.centerline.com

Corporate Headquarters
100 Church Street, 15th Floor
New York, NY 10007
Phone: (212) 317-5700
Fax: (212) 317-5704

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