

National American
Indian Housing Council



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Convention and Trade Show
Low Income Housing
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Indian Country Tax
Credit Deals:
A Tour of the Legal Agreements

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The TDHE:

- Forms the Limited Liability Company (“LLC”) or limited partnership that owns the project
- Has the role of managing member of the LLC
- Has the role of developer of the project
- Has the role of property manager

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The Tribe:

- Provides the site through a long term lease
- Provides supporting resolution(s)
- May provide site improvements
- Has the role of government authority (e.g. tribal zoning laws, buildings codes, licensing laws, employment law, etc.)

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The Players In a Typical
Indian Country Tax Credit Deal



The LLC

- Applies for the tax credits
- Owns the Project

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The Players In a Typical Indian
Country Tax Credit Deal



The State Tax credit allocating agency

- Formulates the State's qualified allocation plan
- Awards the States allocation of low income housing tax credits
- Regulates compliance with I.R.C. § 42

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The Investor(s)

- Invests equity in the project in return for the tax benefits
- Has the role of non-managing member in the LLC
- Often acts through a single asset entity formed by a syndicator

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- The TDHE's deal with the Tribe
- The TDHE's/LLC's deal with the tax credit allocating agency
- The TDHE's/LLC's deal with the investor
- The TDHE's deal with the LLC

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Other "Deals" Within a Tax Credit Project



There are many other deals involving legal agreements in a typical tax credit project that we will NOT cover:

- The deal with the construction lender
- The deal with other permanent sources of financing, e.g.,
 - Federal Home Loan Bank
 - Rural Development
 - State Agency that administers the HOME program
 - Other permanent lender
- The deal with the design professional
- The deal with the construction contractor
- Other deals (consultants, accountants, lawyers, title companies, surveyor, etc.)

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Why an LLC?



The LLC applies for the tax credits and owns the project because:

- Under the LIHTC program private investors invest in an affordable housing project based on the present value of fifteen years worth of federal income tax benefits
- Tax credits have no value to tribes and TDHEs because tribes and TDHE pay no federal income taxes
- The LLC allows TDHE's to take advantage of the LIHTC program by giving 99.99% of the tax benefits to the investors who can use them.
- The TDHE gets the homes for tribal members

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The Deal With The Tribe



- Minimum fifty year lease from the Tribe to the TDHE, including approval of sublease or assignment to the LLC
- The LLC must own the Project
- Tribal Support for the application
- Assurances utilities, roads, easements, etc.
- The lease must be approved by BIA

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The Deal With The Tax Credit Allocating Agency



Under IRC Section 42(m), State Agency must determine the financial feasibility and viability of a Project as a qualified LIHTC project

- At the time of application
- At the time of allocation
- At the time the project is placed in service

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State Agency has ongoing obligation to assure project compliance. If State monitoring reveals non-compliance,

- State Agency will inform IRS
- IRS may deny credits or recapture credits already claimed
- Investors will pursue indemnification and other remedies from the TDHE

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Reservation Agreement

- Confirms that credits have been reserved for the applicant based on review of the application
- Requires that the applicant agree to meet all of the commitments set forth in the application as to the percentage of units to be reserved for low income families
- Requires that the applicant provide supplemental application material by a stated date
- Often requires payment of a fee

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Carryover Agreement.

Under IRC Section 42(h)(1)(B), an allocation of LIHTCs must be made "not later than the close of the calendar year in which the building is placed in service" but almost all projects take advantage of an exception that allows an allocation to a project that is placed in service "not later than the close of the second calendar year following the calendar year in which the allocation is made," PROVIDED, that, within one year after the allocation, the taxpayer's basis in such project is more than 10 percent of the taxpayer's reasonably expected basis in the completed project.

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Carryover Agreement

The Carryover agreement

- Allocates the Credits
- triggers the period for satisfying the 10% test: Applicant must expend 10% of reasonably expected basis within twelve month after the allocation of credit (increased to twelve months by the 2008 Housing and Economic Recovery Act)

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Final Application

- Submitted within six months after project is placed in service, i.e., the date that the credit period begins
- Certificates of occupancy of each unit
- Architect's certificate of completion
- Cost certification showing 10% test satisfied
- Certified Rent rolls

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8609 "Low Income Housing Credit Allocation Certification"

- Issued by the State Allocating Agency after review of the final application
- The State official must certify under oath that the allocation meets the requirements of IRC Section 42
- The LLC files this form with its tax returns
- Investors use form 8586 to claim the credit
- Issued by State Agency each year pursuant to applications made by the LLC

Annual Application for 8609 similar to the "final application" described above

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The Deal With The Tax Credit Allocating Agency



Extended Low Income Housing Commitment Required by IRC Section 42(h)(6)

The Extended Use Agreement, or "Land Use Restriction Agreement" ("LURA") must

- Establish an "extended use period" fifteen years beyond the initial 15-year compliance period
- Require that the units remain reserved for persons at the income levels stated throughout the extended use period
- Allow income-qualified individuals to enforce the agreement in court
- Prohibit partial sale of project units
- Prohibit discrimination against holders of Section 8 vouchers
- Be binding on the taxpayer's successors
- Be recorded pursuant to state law as a restrictive covenant

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The TDHE's Deal With The Investor – Subscription Agreement



Managing Member's Representations, Warranties and Agreements

- The Investor is going to put its money into your LLC, based on the present value of the tax benefits over the fifteen year compliance period.
- The tax benefits depend on the Project's compliance. Representations, Warranties and Agreements address events that might lead the investor to lose the tax benefits.
- If they do happen, and if they result in the loss of tax benefits, you're liable to the investor.

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Managing Member's Representations, Warranties and
Agreements

You promise that

- You're legally formed under the law
- You have the authority to sign the agreement
- You have title to property
- There are no outstanding taxes, zoning violations,
litigation or environmental hazards
- The loan documents and commitments for other
finance sources are valid
- You're insured
- Utilities are in place

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Managing Member's Representations, Warranties and Agreements
(cont.)...

- There's road access
- Your contractors have been paid
- Construction will be compliance with all applicable laws and
regulations
- You haven't violated any laws that would affect the Project
- You'll do everything you can to make sure that you'll do what you
said you would do in the Carryover agreement
- You've met the 10% test
- Your initial budget is reasonable and you'll have enough to pay debt
services and fund operating reserves, debt reserves
- When the Project is completed, the accountants will certify the costs
- Everything you've ever told investors is correct to the best of your
knowledge

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The Investor also makes Representations,
Warranties and Agreements but not many:

- I'm familiar with Section 42
- I acknowledge that there's risk

Documents to be Delivered at Closing: Lists the documents to be
delivered at closing, including that a Legal Opinion from
Managing Member's Counsel

- Carryover has occurred
- LLC is validly formed and in good standing
- LLC has authority to own the Project
- Investor doesn't have liability beyond its investment
- LLC has the authority to enter into the agreement
- Agreements have been duly authorized
- Agreements don't violate any other agreements of the LLC

(cont...)

The TDHE's Deal With The Investor – Subscription Agreement



The Opinion of counsel typically opines that: (cont....)

- Subscription Agreement and Operating Agreement are enforceable
- Guarantor has the authority to enter into the Guaranty Agreement
- Guaranty Agreement has been duly authorized
- Guaranty Agreement doesn't violate any other agreements that the Guarantor has entered into
- Subscription Agreement and Operating Agreement are enforceable
- Company has good and clear title to the Project
- Execution of the Agreement will admit the investor

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The TDHE's Deal With The Investor – Subscription Agreement



INDEMNIFICATION

Parties are liable to each other for breaches of their respective Representations, Warranties and Agreements

The stakes are much higher for the managing member than for the investor.

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ATTACHMENTS AND EXHIBITS

- Amended and Restated Operating Agreement
- Completion Guaranty Agreement
- Operating Deficit Guaranty Agreement
- Flood Plain Certificate
- Environmental Reports
- Loan Documents
- Contracts
- Insurance Policies
- Certificate of no litigation

(cont...)

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ATTACHMENTS AND EXHIBITS

- Budget
- Sources & Uses
- Financial Statements
- Guaranty
- Carryover
- Extended Use Agreement
- Carryover Expenditures
- Managing Member Questionnaire
- Authorizing Resolutions

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The TDHE's Deal With The Investor-
Amended and Restated Operating
Agreement



The Subscription agreement focuses on the terms under which the investor will become a member of the Company. The Amended and Restated Operating Agreement is the parties' agreement as to how the Company will operate once the investor is a member.

- This Agreement is the deal between the managing member (i.e., the TDHE) and the investor dividing the financial benefits and management responsibilities.

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The TDHE's Deal With The Investor-
Amended and Restated Operating
Agreement



It addresses:

Capital contributions of the investor and the timing of the payments based on certain benchmarks, e.g.

- 10% at closing
- 60% during construction, pursuant to a draw process
- 25% after completion, upon conversion of construction loan to permanent financing, issuance of certificates of occupancy,
- 5% after full occupancy, verification of credit eligibility, verification of tenant income, etc.

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Allocation of profits and losses, depreciation
and credits, deductions

- 99.99% to the Investor Member
- 00.01% to the Managing Member

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Distributions from Cash from Operations
Typical Amended and Restated Operating
Agreements provide that cash flow is distributed in accordance
with stated priorities:

- Investor to make up for any shortfalls in projected credits or to amounts recaptured from the investor
- Debt service
- Developer fee
- Pre-payment on mortgage loans
- 99.99% of the remainder to the investor, 00.01% to the managing member

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The TDHE's Deal With The Investor-
Amended and Restated Operating
Agreement



Typical Amended and Restated Operating Agreements provide that the managing member:

- Generally has the full and exclusive right and power to manage and control the business and affairs of the Company
- Is responsible for keeping the Company's books and records
- Must cause the Project to be constructed and operated in accordance with all applicable federal, state tribal and local laws, and laws relating to health, safety, equal opportunity, zoning and accommodation of disabled persons

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The TDHE's Deal With The Investor-
Amended and Restated Operating
Agreement



Typical Amended and Restated Operating Agreements provide that the managing member is responsible for:

- causing the company's independent CPAs to prepare the annual federal tax returns and furnishing the returns to the investor members for review before filing
- providing annual audited financial statements to the Investor Member, including balance sheets and statements of operation and addressing specific tax depreciation issues
- providing a compliance report prepared by a third party confirming that the Project tenants meet the requirements of IRC Section 42
- providing copies of reports filed with the State tax credit allocation agency
- Preparing an annual business report reflecting occupancy rates, maintenance performed, cash flow requirements, inspection results, etc. (Cont...)

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The TDHE's Deal With The Investor-
Amended and Restated Operating
Agreement



Typical Amended and Restated Operating Agreements provide that the managing member is responsible for:

- Preparing an annual budget
- Providing evidence of effective insurance coverage
- Providing quarterly financial statements
- Providing quarterly tenant income summaries
- Providing a quarterly certificate that the Project complies with the requirements of IRC Section 42 and affirming the absence of various adverse circumstances
- Providing a quarterly property inspection report

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The TDHE's Deal With The Investor-
Amended and Restated Operating
Agreement



Typical Amended and Restated Operating Agreements provide that the managing member

- Has the power to borrow money, refinance existing debts and mortgage company assets
- Acquire and enter into contracts of insurance
- Employ employees, agents, independent contractors, attorneys, accountants, supervisory managing agents, etc.
- Prepare reports, statements, and other relevant information
- Open bank accounts
- Enter into agreements and contracts
- Establish and maintain reserves for working capital and contingencies
- To sue on, defend or compromise any and all claims or liabilities on behalf of the company

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The TDHE's Deal With The Investor- Amended and Restated Operating Agreement



Typical Amended and Restated Operating Agreements provide that the Investor member:

- Is not liable for the Company's obligations beyond its investment
- Except as provided in the agreement, will not participate in management of the Company
- Has the right to remove the managing member for cause, following notice and failure to cure, including
 - Failure to perform material obligations set forth in the Agreement (e.g., failing to operate the Project in accordance with Section 42, provide required reports, verify tenant income, etc.)
 - Criminal conduct involving dishonesty
 - Fraud, gross negligence or breach of fiduciary duty
 - Failure to fulfill obligations as guarantor

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The TDHE's Deal With The Investor- Amended and Restated Operating Agreement



Typical Amended and Restated Operating Agreements involving tribal tax credit projects provide that

- The managing member TDHE will be the Project developer and earn a fee for developer services.
- The managing member TDHE will be the Project property manager and earn a fee for property management services
- The managing member TDHE will have an option to acquire the investor member's membership interest at the end of the compliance period by paying an amount equal to (i) any outstanding debt, (ii) any taxes attributable to the sale, and (iii) expenses of sale
- In the event the investor member wishes to sell the Project, the managing member has a right of first refusal

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The TDHE's Deal With The Investor- Amended and Restated Operating Agreement



Managing Member Warranties and Covenants

Amended and Restated Operating Agreements provide for managing member representations and warranties similar to those included in the subscription agreement. A typical amended and restated operating agreement requires the managing member to warrant that

- it will use its best efforts to cause all requirements of any loan agreement to be met, including the extended use or deed restriction agreement entered into with the state agency
- it will use its best efforts to comply with rent restrictions or low income set-asides agreed to in connection with other funding sources

(Cont...)

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The TDHE's Deal With The Investor- Amended and Restated Operating Agreement



Managing Member Warranties and Covenants

Amended and Restated Operating Agreements provide for managing member representations and warranties similar to those included in the subscription agreement. A typical amended and restated operating agreement requires the managing member to warrant that

- appropriate roadways and public utilities, including sanitary and storm sewers, water and electricity, are currently available to the Project, or will be available prior to the date scheduled for completion and the managing member will use its best efforts to keep utilities operating properly
- the Company owns a valid leasehold interest in the land and title is not subject to any material liens, charges or encumbrances that would adversely affect the ability of the Company to construct the Project
- the operation and use of the Project does and will conform to all applicable material rules and regulations of any government agency having jurisdiction

(Cont...)

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The TDHE's Deal With The Investor-
Amended and Restated Operating
Agreement



- (Cont...) A typical amended and restated operating agreement requires the managing member to warrant that
- all required escrows, reserves and financial assurances for the Project are, and will continue to be, fully funded
 - all required government approvals have been obtained
 - there are no claims, litigation or other proceedings pending or threatened against the Company or the Project
 - the Company is (and will continue to be) a duly organized Company validly existing under the laws of its charter
 - no material default exists under any agreements with the Lenders;

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The TDHE's Deal With The Investor-
Amended and Restated Operating
Agreement



- (Cont...) A typical amended and restated operating agreement requires the managing member to warrant that
- no event has occurred, and the Managing member will not cause and event to occur, which will cause a breach or default under any provision of law, any order of court, or agreement affecting the Company
 - Managing Member will exercise good faith in all activities relating to the conduct of the business of the Company
 - the warranties and representations of the Managing Member made in the Subscription Agreement are true and accurate
 - the Managing Member will comply with the restrictions imposed by the extended use agreement
 - the Managing Member shall ensure that the Project contains no Environmental Hazard and is not in violation of any federal, state, or local statute, law, regulation, rule, or ordinance

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The TDHE's Deal With The Investor- Operating Deficit Guaranty



Summary: The Tribe or TDHE guarantees that, in the event the Company can't pay its bills at any time during the fifteen-year compliance period, the Guarantors will pay them.

The Guarantor, usually the managing members (i.e., the TDHE) agrees to pay all obligations of the Company, including its

- operating expenses
- reserve and escrow account obligations under the Amended Operating Agreement or under loan agreements
- debt service payments
- maintenance and capital replacement expenses

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The TDHE's Deal With The Investor- Tax Credit Guaranty



Summary: The Guarantor (usually the managing member, ie. the TDHE) guarantees that the investor will received the bargained for tax credits.

The Guarantor guarantees that

- During each year during the Compliance Period, the Company will comply with all applicable provisions of Section 42 of the Code to the extent necessary to be eligible for 100% of the tax credits for which the Company is eligible.
- If in any year the Company cannot claim the maximum credits, the Guarantor has to make up the difference.
- If any credits are recaptured from the investors, the Guarantor has to pay the investors the amounts recaptured, plus any interest or penalties.

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The TDHE's Deal With The Investor- Completion Guaranty Agreement



The Guarantor, usually the managing member (i.e., the TDHE) guarantee that the Company will

- acquire the property pursuant to a ground lease
- complete the Project in accordance with the plans and specifications, applicable laws, etc.
- pay all Project costs, finance costs, reserves
- pay all operating expenses and capital maintenance if Project revenue is insufficient
- assure that, within a reasonable period of time after construction, the only Project debt is the permanent financing approved by the investor
- pay any costs resulting from title, environmental problems, construction damage, or soil problems

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The TDHE's Deal With The Investor- Completion Guaranty Agreement



A typical Completion Guaranty will require that the Guarantor purchase the investors' interest in the project for a price equal to their capital contributions (often plus interest and plus a lump sum fee) if

- the Guarantors fail to meet their guaranty obligations
- the Project does not provide tax credits by a specified date
- construction is not commenced by a specified date
- the construction loans are not paid off by a specified date

These are triggers that potentially provide investors with the opportunity to exit. The investor may be motivated to remain, however.

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The Assignment or Sublease

- Transfers to the LLC the 50-year lease that the Tribe gave the TDHE
- Provides the LLC with the legal ownership of the Project that the LLC needs in order to claim the tax credits
- May involve a separate assignment or sublease for each unit if the goal is to transfer ownership to tenants at the end of the compliance period
- Allows for a termination of the sublease (or reassignment back to the LLC) at the end of the 15-year compliance period when the investors exit the LLC
- Must be approved by BIA

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The Development Agreement

- Is between the LLC and the TDHE but requires the approval of the State Agency, the investor and, often, other funding sources
- Describes the services the THDE will perform as developer
- States the compensation to be paid for the developing the project – the Developer Fee

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The Development Agreement

- The Developer fee typically may not exceed 15% of total project cost
- States how the Developer Fee will be paid
 - Often a portion (20-25% at closing) is paid when the investor joins the LLC
 - Remainder is *earned* when the project is complete but paid when all other project expenses are paid
 - A portion may be deferred, i.e., not paid from the project financing but paid instead from cash from operations

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The management agreement, or "property management agreement"

- Is between the LLC and the TDHE but requires the approval of the State Agency, the investor and, often, other funding sources
- Describes the TDHE's duties and responsibilities as property manager during the 15-year compliance period
- States the compensation to be paid for management services
- States how the management fee will be paid – Usually subordinate to other operating expenses

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The management agreement, or "property management agreement"

- Often includes a management plan
- Is very detailed and focuses on compliance with IRC Section 42
 - Income verification
 - Rents
 - maintenance & repairs
 - bookkeeping
 - Reports
 - Etc.

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- Tax credit equity can prove hugely effective in meeting tribal members' housing needs but, like many other things worth having, requires hard work.
- Tax credits are not for the weak of heart
- If the TDHE complies with Section 42, everyone will be happy

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Thank You



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