CALIFORNIA TAX CREDIT ALLOCATION COMMITTEE

915 Capitol Mall, Suite 485
Sacramento, CA 95814
p (916) 654-6340
f (916) 654-6033
www.treasurer.ca.gov/ctcac

DATE: February 1, 2019

TO: Low Income Housing Tax Credit Project Applicants and Owners

FROM: California Tax Credit Allocation Committee – Development Section

RE: Re-syndication Requirements

The California Tax Credit Allocation Committee (TCAC) receives applications for projects that seek to apply for a new reservation of 9% or 4% tax credits (i.e., re-syndication). All re-syndications applications must include the following documents in addition to the items outlined in the application checklist:

- ☐ A copy of the TCAC recorded regulatory agreement
- ☐ A confirmation letter from the seller that the seller will transfer tenant records and all tenant demographic data collected up to the date the sale closes escrow to the buyer and their property management agent
- ☐ A reserve certification indicating that all unexpended funds in the project reserve funds associated with the project will remain with the project (Section 10327(c)(7)). Certification can be accessed from our website at: http://www.treasurer.ca.gov/ctcac/compliance/covenant/reserve.docx
- ☐ The questionnaire below

Re-syndication Questionnaire

1. Does your Transfer Event qualify for an exemption because the project's existing TCAC regulatory agreement has a remaining term of 5 years or less?
   - ☐ Yes. Answer question 4.
   - ☐ No. Answer questions 2, 3, and 4.

2. Does your Transfer Event qualify for a full waiver from the requirements of 10320(b)(4)(B) because there are no distributions of Net Project Equity from the Transfer Event to parties related to the sponsor, developer, general partner(s) or limited partner(s) of the owner other than a distribution or a payment to the limited partner(s) of the selling entity in the amount equal to, or less than, all federal, state, and local taxes incurred by the limited partner(s) as a result of the Transfer Event?

☐ Yes. Provide a Worksheet of Sale Proceeds* which computes Net Project Equity as defined in TCAC regulation section 10302(cc). Proceed to Question 4.
☐ No. Proceed to Question 3.
☐ Not applicable pursuant to Question 1.

3. Does your Transfer Event qualify for a partial waiver from the requirements of Section 10320(b)(4) because the distributions of Net Project Equity to parties related to the sponsor, developer, general partner(s) or limited partner(s) of the owner, other than a distribution or a payment to the limited partner(s) of the selling entity in the amount equal to, or less than, all federal, state, and local taxes incurred by the limited partner(s) as a result of the Transfer Event, are less than the Short Term Work Amount?
   ☐ Yes.
   ☐ No.
   ☐ Not applicable pursuant to Question 2 or 3.

   For either a "Yes" or "No" answer, provide:
   ☐ a Worksheet of Sale Proceeds* which computes Net Project Equity as defined in TCAC regulation section 10302(cc); and
   ☐ a current Qualified Capital Needs Assessment, as defined in Section 10302(ff), for the property.

4. a) Is your project currently subject to a Capital Needs Agreement as a condition of a previous Transfer Event?
   ☐ Yes. Provide a copy of the Capital Needs Agreement.
   ☐ No.

   b) If the answer to 4a) is yes, has the acquisition price increased between the initial Transfer Event and the re-syndication?
   ☐ Yes. Provide:
      ☐ an appraisal or other documentation that calculates what portion of the increase is due to a reduction in annual deposits to the replacement reserve account between the amount cited in the Capital Needs Agreement and the TCAC minimum reserve deposit requirements; and
      ☐ a statement of how the project complies with the requirement that the difference in value attributable to a reduction in the replacement reserve deposits be evidenced by a seller carryback note or general partner equity contribution.
   ☐ No.

*Sample Worksheet of Sale Proceeds:
Sale proceeds: $

<u>Sources</u>

Existing Debt[1]	$
Seller Carryback (residual receipts)	$
General Partner Equity	$
Deferred Developer Fee	$
Other sources (list separately)	$

Sale Proceeds less Total Sources equals Net Project Equity Distribution: $

[1] Must match Attachment 2-A3 or the Tab 2 financing plan.

If your Transfer Event is not occurring concurrently with a re-syndication please refer to the TCAC Compliance Transfer Event questionnaire on TCAC's website. Furthermore, if the responses noted on this completed Questionnaire do not match any of the above scenarios or if you have any additional questions, please contact your regional analyst for guidance.

After a project has received a new reservation of credits, the existing regulatory agreement must be assigned to and assumed by the new owner. At your earliest convenience, please forward Connie Harina and Gina Ferguson a draft of the assignment and assumption of regulatory agreement and any standstill and/or subordination agreement the lender may require, along with the anticipated closing date.

QUESTIONS AND ANSWERS (Q&As)

1. **What is a re-syndication project?**

   Re-syndication refers to the process where an existing tax credit project requests a new reservation of tax credits to finance the rehabilitation of the existing tax credit project.

2. **When can I apply for a new reservation of credits (re-syndicate)?**

   You may apply for a new reservation of tax credits concurrently with the initial, expiring 15-year federal compliance period. The acquisition date and the placed in service date must occur after the existing federal 15-year compliance period has expired.

3. **How is the initial 15-year compliance period determined?**

   The 15-year compliance period begins on the first day of the taxable year of the credit period. In other words, the credit and compliance periods will begin the same year.

   For example, a project is placed in service on July 1, 2001. Most LIHTC property owners are limited partnerships with taxable years beginning on January 1st, so the compliance period begins on January 1, 2001 and ends on December 31, 2015. See Internal Revenue Code §42(i)(1).

4. **What is the difference between an exemption and a waiver of the Transfer Event Short Term Work requirements?**

   A re-syndication project is exempt from Transfer Event Short Term Work requirements only if the project is subject to an existing tax credit regulatory agreement with a remaining term of five or less years.

   A re-syndication project may receive a waiver of the Transfer Event Short Term Work requirements if there is no distribution of Net Project Equity. Development Section staff will consider the waiver as part of the application review (see Questions 9 and 10).

5. **What if the transfer is not occurring concurrently with a re-syndication?**

   Refer to the compliance transfer event questionnaire on the TCAC website. If you have questions after reviewing the compliance questionnaire, please contact Compliance Program Managers, Shannon Nardinelli and Mayra Lozano by email, or by phone at (916) 654-6340.

6. **When does a Capital Needs Agreement apply?**

   A capital needs agreement is a document recorded on title when there is an equity cash out not occurring concurrently with a re-syndication (Question 5). The document is recorded on title and outlines the Short Term Work to be completed within 3 years from the date of the Transfer Event and any deposits to reserves as necessary to fund the long term work.

7. **Assume a project is subject to a Capital Needs Agreement due to a prior Transfer Event and Net Project Equity take out. If there will be additional equity take out (Net Project Equity distribution) with the re-syndication application, would this qualify for a waiver?**

   No. If additional equity is being taken out, the project would not be eligible for a waiver and the re-syndication application must exclude from basis the costs of the Short Term Work unless one of the four funding sources described in answer 14b) is included.

8. **If a project is subject to an existing Capital Needs Agreement, can the project take eligible basis on the Short Term Work required by the Capital Needs Agreement?**

   In many cases, the Short Term Work should already be completed because it has been more than 3 years since the Capital Needs Agreement was signed.

   If it has been less than 3 years since the Capital Needs Agreement was signed and some or all of the Short Term Work required by the Capital Needs Agreement will be done as part of the rehabilitation, the project may include the costs in eligible basis, excluding any amount of the remaining Short Term Work reserve from the Capital Needs Agreement. Tax credits shall not pay for work funded already by the seller from the Initial Transfer Event. In addition, the applicant shall include the Short Term Work reserve funds required by the Capital Needs Agreement as a financing source. Since the funds have already been set aside for these costs, they must be spent for that purpose.

   If it has been more than 3 years since the Capital Needs Agreement was signed, the costs of any Short Term Work required by the Capital Needs Agreement may not be included in basis. The project is in violation of the Capital Needs Agreement, and TCAC will not award tax credits for completion of this work.

9. **If a project is not subject to an existing Capital Needs Agreement and the Transfer Event associated with a re-syndication will not distribute Net Project Equity to parties, are there any restrictions on including all rehabilitation costs in eligible basis?**

   No. Notwithstanding that the re-syndication may be a Transfer Event, because the project is not under a Capital Needs Agreement at the time of re-syndication and the transfer associated with the re-syndication distributes no Net Project Equity to parties, upon verification TCAC will waive the requirement to fund the Short Term Work. As part of the TCAC re-syndication application, the applicant must submit a Worksheet of Sale Proceeds from the transfer which calculates the Net Project Equity and demonstrates that the transfer does not distribute Net Project Equity to parties.

   Sample Worksheet of Sale Proceeds:
   Sale proceeds: $

   Sources

Existing Debt[2]	$
Seller Carryback (residual receipts)	$
General Partner Equity	$
Deferred Developer Fee	$
Other sources (list separately)	$

   Sale Proceeds less Total Sources equals Net Project Equity Distribution: $

[2] Must match Attachment 2-A3 or the Tab 2 financing plan.

Please be aware that TCAC will make this determination during the application review based on documentation included in the application. If it is determined there is a Short Term Work requirement and the application incorrectly excluded a Short Term Work requirement, the application must be corrected. If there is insufficient time for this to occur, the application will be removed from the scheduled Committee meeting.

10. If the re-syndication will not distribute Net Project Equity, should the applicant should differentiate immediate needs/short term work from any other rehabilitation work?

No. If TCAC determines there is no Net Project Equity being distributed, the Short Term Work requirement is waived. Please be aware that TCAC will make this determination during the application review based on documentation included in the application. If it is determined there is a Short Term Work requirement and the application incorrectly excluded a Short Term Work requirement, the application must be corrected. If there is insufficient time for this to occur, the application will be removed from the scheduled Committee meeting.

11. If a re-syndication project excludes the costs of Short Term Work from basis or includes an adequate amount of the funding sources described in answer 14b), may the seller pull cash out (Net Project Equity distribution) even if it is a related party transaction?

Yes.

12. What is a Qualified Capital Needs Assessment (QCNA) and when is it required?

<u>QCNA</u>:

a) Meets the requirements of (a) the Fannie Mae Multifamily Instructions for the PNA Property Evaluator, (b) Freddie Mac's Property Condition Report requirements in Chapter 14 of the Small Balance Loan Addendum, (c) HUD's Multifamily Capital Needs Assessment section in Appendix 5G of the Multifamily Accelerated Process Guide, or (d) Standard Guide for Property Condition Assessments: Baseline Property Condition Assessment Process (ASTM Designation E 2018-08) utilizing a recognized industry standard to establish useful life estimates for the replacement reserve analysis;
b) Is commissioned by a third-party lender;
c) Prepared within 180 days of the proposed transfer event; and
d) Includes a pre-rehabilitation reserve study that clearly sets forth:
    i. the capital needs of the project for the next 3 years (Short Term Work) and the projected costs thereof, AND
    ii. the capital needs of the project for the subsequent 12 years (long term work) and the projected contributions to reserves that will be needed to accomplish that work.

A QCNA is required for all re-syndications, including those that receive a waiver of or are not subject to Short Term Work requirements.

NOTE: When there is a Net Project Equity distribution the 15 year pre-rehabilitation reserve study in the QCNA <u>must</u> demonstrate a rehabilitation need of at least $5,000 per unit over the first three years (Short Term Work, see Question 13).

Please refer to Sections 10302(ff), 10320(b)(4), 10322(h)(26)(B), and 10325(f)(11)(C).

13. **Re-syndications with a distribution of Net Project Equity are subject to TCAC's Transfer Event Short Term Work requirement. How does TCAC verify the Short Term Work requirement is met?**

The Qualified Capital Needs Assessment (QCNA) must demonstrate immediate rehabilitation needs of at least $5,000 per unit over the first three years of the 15 year pre-rehabilitation study. This is equal to the aggregate amounts in Years 1-3 of the 15 year pre-rehabilitation reserve study plus any immediate needs if identified separately in the QCNA. (The $5,000 per unit calculation cannot include inflation adjusters for Years 2-3 since all of this work is being performed as part of the rehabilitation and is not spread over a 3 year period.) For example, the QCNA for a 75 unit project must demonstrate at least $375,000 in rehabilitation needs for Years 1-3. If it does not, the project does not qualify for re-syndication.

14. **For re-syndication applications subject to the Transfer Event provisions, how should the Short Term Work amount from the Qualified Capital Needs Assessment (QCNA) be reflected in the re-syndication application?**

a) The Short Term Work is included in the rehabilitation scope of work (Attachment 8). In the Sources and Uses Budget, the Short Term Work is included in the budget either within the rehabilitation costs or as a separate line item. Be sure the costs in the QCNA 15 year pre-rehabilitation reserve study equal at least $5,000 per unit in Years 1-3 (Question 13).

b) If the applicant demonstrates one of the sources listed below in an amount equal to or greater than the Short Term Work amount, the applicant may claim eligible basis for the Short Term Work amount and should not differentiate the Short Term Work from any other rehabilitation work in the Sources and Uses Budget:
   i. a credit from the seller of the project equal to the costs of Short Term Work;
   ii. a reduction in the purchase price of the project as compared to the purchase price of the project had the project not been subject to the Transfer Event requirement, as shown by an appraisal that calculates the impact of the Short Term Work requirement on value;
   iii. general partner equity; and/or
   iv. developer fee contributed to the project (deferred developer fee does not qualify).

c) If the applicant is not eligible for a waiver and does not demonstrate one of the sources listed above in item b), the eligible basis for the Structures line item in the Sources and Uses Budget worksheet of the Excel application should be reduced by an amount equal to or greater than the Short Term Work amount.

15. **There is a seller credit in the amount of the Short Term Work requirement due to a Net Project Equity distribution (Answer 14b)). How should the seller credit be presented in the purchase and sale agreement, the TCAC application, and the Sources and Uses Budget?**

Assume a purchase and sale agreement for $10M, a seller credit of $500,000, and Short Term Work of $500,000. The purchase and sale agreement (PSA) must acknowledge the seller credit of $500,000. The appraisal in the application must support a value of at least $10M. The net purchase price ($9.5M) should be shown in the Sources and Uses Budget since that is what is being paid. Having the PSA verify the full amount ($10M) will sufficiently evidence the seller credit for the TCAC application. In the

Sources and Uses Budget, the Short Term Work is included in the budget either within the rehabilitation costs or as a separate line item.

16. **Does the amount of Short Term Work that must be contributed as described in Question 14b) above (Section 10320(b)(4)(B)) count towards the amount of developer fee that must be deferred or contributed as equity in cases where the developer fee is in excess of TCAC's maximum that may be disbursed (Section 10327(c)(2)(B))?**

    No.

17. **All projects with a reservation of credit made 1997 and later are subject to the requirement that all unexpended funds in project reserve accounts must remain with the project to be used for the benefit of the property and/or its residents. Can the seller require the purchase of the existing reserves?**

    Yes, however the payment will be considered a distribution of Net Project Equity for Transfer Event purposes.

18. **How will TCAC confirm Short Term Work has been completed?**

    For all projects TCAC will require confirmation at placed in service that the applicant completed all of the Short Term Work items or that the Short Term Work items have been rendered moot by the larger rehabilitation work.

19. **If the requirement to provide services amenities in the existing TCAC regulatory agreement has expired, is the project required to provide services in the re-syndication application?**

    If the existing TCAC regulatory agreement for the re-syndication project was required to provide service amenities even if that requirement has expired, the re-syndication project shall provide a similar or greater level of services for a period of at least 15 years under the new regulatory agreement. A project obtaining maximum TCAC points for service amenities shall be deemed to have met this requirement.

    The Executive Director may alter the service amenities requirement if the project (1) has exhibited a cash flow of less than $20,000 for at least each of the last 3 years, (2) has no hard debt and failed to break even in Year 15 with services amenities, or (3) within the next 5 years will lose a rental or operating subsidy that was factored into the project's initial feasibility, provided that the service amenity expenditures are maximized to what project feasibility allows.

20. **For a re-syndication of an existing tax credit project, may the area median income (AMI) rent and income targeting be increased in the new application?**

    The targeted rent and income figures must be maintained at or below the targeted levels required in the existing TCAC regulatory agreement unless approved by the Executive Director due to negative cash flow (see Section 10326(g)(8)).

21. If a re-syndication includes a Subsequent Transfer described in Section 10320(b)(4)(C) and the value of the property has increased from the Initial Transfer, how is the required seller carryback or equity contribution amount determined?

The methodology to calculate the amount of the required seller carryback or equity contribution is as follows:

1) Subtract the original acquisition cost from the new valuation (the "Increased Value");

2) Subtract the aggregate annual replacement reserve contributions required under the standard TCAC replacement reserve requirements from the aggregate annual replacement reserve contributions required by the Capital Needs Agreement. This difference is then divided by the cap rate used in the appraisal associated with the re-syndication (the "Reserve Requirement Value Differential").

   (aggregate annual replacement reserve contributions required by the Capital Needs Agreement - aggregate annual replacement reserve contributions required by TCAC); and

3) The amount of the seller carryback shall be the amount of the Reserve Requirement Value Differential but not in excess of the Increased Value. In the event that assumed third-party secured debt on the property equals or exceeds the property's value from the appraisal associated with the re-syndication, no seller carryback or equity contribution is required.

22. If a re-syndication includes a Subsequent Transfer described in Section 10320(b)(4)(C) and the value of the property has increased from the Initial Transfer, and the seller chooses to provide a carryback loan to meet TCAC requirements, what are the required terms of the seller carryback loan?

The seller carryback shall be a 55-year residual receipts loan payable solely from project cash flow.

23. What will the building identification numbers (BIN's) be for my new application?

All re-syndication projects are required by the IRS to use the existing BIN's for the project. For example if the original BIN was CA-04-00201, the new project will retain that BIN for future IRS filings.

24. Are re-syndication projects eligible to use the California Utility Allowance Calculator (CUAC)?

Yes. Projects applying for tax credits for which the rehabilitation improves energy efficiency by at least 20%, consistent with the requirements of Section 10325(c)(5)(D) and (G), or installs solar generation that offsets 50% of tenant loads, as determined consistent with the requirements of Section 10325(c)(5)(G), are eligible to use the CUAC.

Any decrease in tenant's utility allowance resulting from conversion to the CUAC shall not exceed $15 per month over any 12-month period. Re-syndication projects proposing the CUAC should reflect actual rents in the Excel application no greater than a $15 tenant rent increase. At placed in service, TCAC will compare the pre- and post-CUAC utility allowances and tenant paid rents.