

TYPES NOT MAPPED YET March 17, 2015 | TTR not mapped yet | Mark V. Bossi

LIHTC exit strategies: Loan sale

Note: This post is part of a [continuing series on the Credit Report Blog](#) on the subject of workouts and bankruptcies involving low-income housing tax credit (LIHTC) projects.

Because there is currently a very robust market for distressed debt, a lender's first option for dealing with any non-performing loan is often to look to sell the loan. This post addresses the unique considerations and difficulties involved in the sale of a loan secured by an LIHTC project (referred to herein as an "LIHTC loan").

The difficulties involved in the sale of an LIHTC loan are tied to two features of such loans. The first feature is the highly specialized nature of the affordable housing business and the limited market for such projects (and consequently for LIHTC loans secured by such projects). This feature pervades all LIHTC loans. The second feature relates to the way the loan is structured and comes into play only with respect to LIHTC loans secured by projects involving so-called 4% credits.

Limited market for potential purchasers

Affordable housing is a highly specialized industry, particularly when LIHTCs are involved. As such, there are very few, if any, financial buyers of distressed LIHTC loans (i.e. buyers who are making a financial play that they can collect more from the borrower than they are required to pay for the loan). Typical distressed debt investors simply don't have the time or inclination to understand the complexities of affordable housing and, therefore, are generally interested in loans secured by more common types of real estate or other collateral.

This means that the pool of potential buyers for LIHTC loans will likely consist only of strategic buyers (i.e. buyers who are interested in purchasing a loan in order to gain a strategic advantage with respect to an ownership interest in the property itself). Unfortunately, the pool of strategic buyers is also quite limited. Many developers of market-rate properties are simply unwilling to wade into the waters of affordable housing. Although an LIHTC property can be converted to a market-rate property under certain circumstances (such as following a foreclosure), the value of a property as a market-rate property is most often significantly less than its value as an LIHTC property because of the additive value of the tax credits that are available only if the property continues to be operated as an LIHTC property. Moreover, the ability to convert an LIHTC property to a market-rate property is often constrained by market factors. Thus, the sale of an LIHTC loan (or the sale of the LIHTC property itself) to a buyer that anticipates converting the property to a market-rate property is generally unlikely to be a lender's best option.

In short, the pool of potential purchasers for an LIHTC loan is typically limited to other affordable housing developers. Not only is this pool quite shallow, but there are few such developers who have experience in buying distressed debt and are interested in taking on the headaches associated with a failed LIHTC project.

9 percent credits vs. 4 percent credits

There are two different types of federal LIHTCs: 9% credits and 4% credits. Financing for a project involving 9% credits is structured like any other conventional construction or construction-to-permanent financing. In other words, a loan will be made directly by the lender to the borrower and the loan will be secured by a mortgage on the 9% LIHTC property. On the other hand, financing for a project involving 4% credits will be structured through bonds issued by a local public authority. The bonds will either be sold directly to the lender or will be sold to third-parties and credit enhanced by a letter of credit issued by the lender. The bonds and/or borrower's reimbursement obligation under the letter of credit will then be secured by the 4% LIHTC property.

The sale of an LIHTC loan secured by a 9% LIHTC property is relatively straightforward. There are comparatively few restrictions on the transfer of such a loan and the lender can simply transfer its interest in the loan and the loan documents to the purchaser. However, the sale of an LIHTC loan secured by a 4% LIHTC property is much more complicated.

With respect to bonds that have been purchased by the lender directly from the authority, the governing bond documents will typically restrict any re-sale of the bonds to a particular class of purchasers. Such restrictions typically limit the sale of bonds to (a) a “Qualified Institutional Buyers” (QIBs) as defined in [Rule 144A](#) under the Securities Act of 1933, as amended, (b) “Accredited Investors”, as defined in [Rule 501\(a\)\(1\)-\(3\)](#) of Regulation D under the Securities Act of 1933, as amended, or (c) some combination or subset of (a) and (b). In addition, the governing bond documents will include various documentation requirements for a transfer of the bonds, such as a requirement that the purchaser execute a letter of representation certifying that it meets the transfer restrictions and making certain other required representations.

Only very sophisticated institutional organizations, such as banks, qualify as QIBs. As such, a provision in the governing bond documents restricting transfers to QIBs will significantly limit the number and types of potential purchasers. A restriction on transfers to Accredited Investors opens up the market to a broader class, including certain high net worth or income individuals, but is still quite restrictive.

With respect to bonds which were previously secured by a letter of credit, and which are now held by the lender following a draw under the letter of credit and an optional or mandatory tender of the bonds, the operative bond documents may either prohibit a transfer of the bonds or may require certain additional documentation from the purchaser given that the bonds contemplate that holders will have the security of the letter of credit which is no longer available. Moreover, if the bonds have been redeemed and the lender is selling its rights under a letter of credit reimbursement agreement, various other complications come into play.

Given the obstacles associated with the sale of an LIHTC loan, is it still a viable alternative?

Because of the small market for potential purchasers and the various restrictions and complications concerning transferability, it is extremely difficult to sell an LIHTC loan. However, it is not impossible and the obstacles to such a sale can be overcome in certain circumstances. Based on our experience, we have the following observations concerning the sale of an LIHTC loan:

- It is extremely difficult to sell an LIHTC loan through typical distressed debt markets.
- Strategic buyers are the best prospects for purchasing an LIHTC loan.
- Strategic buyers are most likely to be identified through industry sources.
- The sale of an LIHTC loan is more likely to occur when the borrower is cooperative and participates in the process.
- Negotiations concerning the sale of an LIHTC loan are complicated and will involve issues unique to the particular transaction.
- When bonds are involved, the issuing authority is sometimes willing to waive or modify transfer restrictions to enable a sale of the bonds to an identified purchaser that would not otherwise qualify.

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