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# LIHTC/HTC Transactions Utilizing the Master Lease Pass-Through Structure


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# LIHTC/HTC Twin Deals: Single Tier Structure

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**Singler-Tier Structure**

- Project Owner is owned 99.99% by Federal Investor and 0.01% by Sponsor Affiliate as Managing Member ("MM")/General Partner ("GP")
  - MM/GP likely will have a larger share (90%) of cash flow and capital transaction proceeds after the end of the 5-year HTC compliance period
- Federal Investor is allocated 99.99% of LIHTC and HTC
- Federal LIHTC/HTC Investor contributes equity to Project Owner for LIHTC and HTC
- Project Owner reduces depreciable and eligible basis by the amount of the HTC

**Master-Lease Pass-Through Structure**

- Landlord constructs the property and Master Tenant operates the property
- Federal LIHTC Investor and Federal HTC Investor (“FHTC Investor”) must be different
- Project Owner is NOT required to reduce depreciable and eligible basis by the amount of the HTC
- Under 50(d), FHTC Investor is required to include in income an amount equal to 100% of FHTC. FHTC Investor amortized 50(d) income over the shortest applicable MACRS period, generally 27.5 years.
- Project Owner/Landlord is owned 98.99% by Federal LIHTC Investor, 1% by Master Tenant and 0.01% by Sponsor Affiliate as MM/GP
  - MM/GP may own more than 0.01% of cash flow and/or capital transaction proceeds in the Landlord from day one

## Master-Lease Pass-Through Structure

- Project Owner rehabilitates building/incurs QREs, master leases Project to the Master Tenant and elects to pass-through the Federal HTC to Master Tenant
- Master Tenant is owned 99% by FHTC Investor and 1% by Sponsor Affiliate as MM/GP.
  - FHTC Investor's interest in Master Tenant may flip down to as little as 5% following expiration of 5-year HTC compliance period.
- Master Tenant allocates 99% of Federal HTC to FHTC Investor
- FHTC Investor contributes equity to Master Tenant. Master Tenant contributes FHTC equity to Landlord

# Structure Chart

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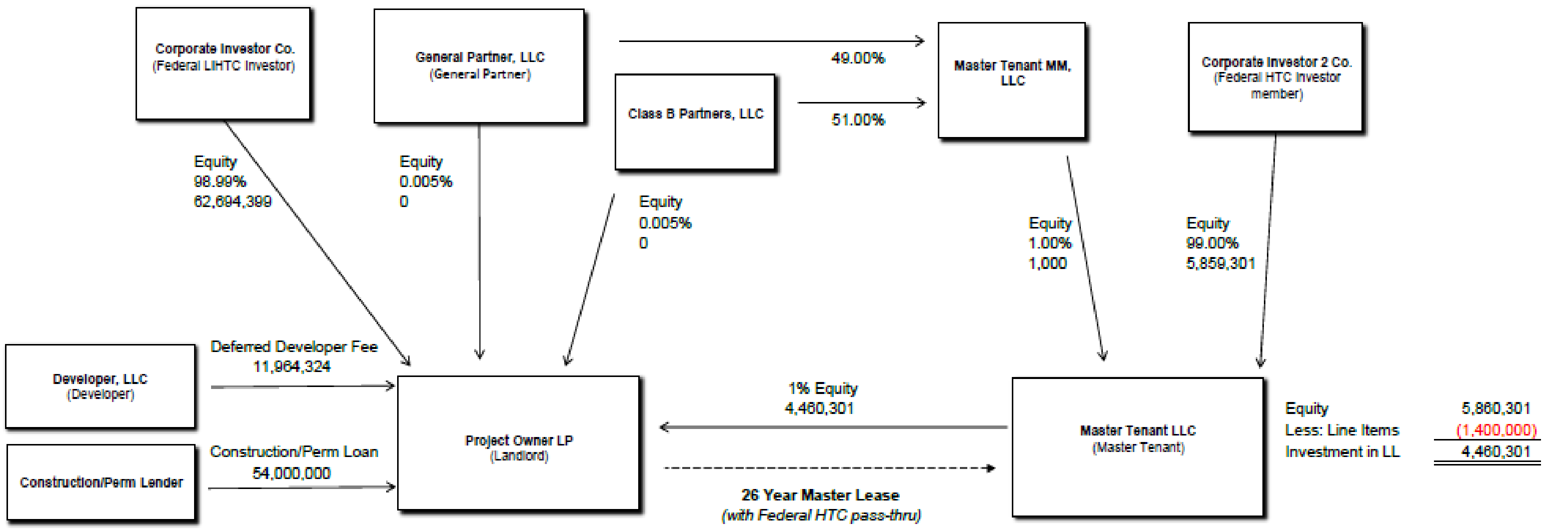
SAMPLE LIHTC/HTC LEASE PASS THROUGH PROJECT

**Proposed Ownership Structure for Rehabilitation Project**
*As of June 1, 2023 (Anticipated Closing)*



# Master Lease Pass-Thru

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**LANDLORD:**

- Master Tenant contributes FHTC equity to Landlord and is allocated 1% of LIHTC.
  - Will FHTC Investor pay for 1% of LIHTC? If not, will Investors allow special allocation of 99.98% of depreciation and LIHTC to be allocated to Federal LIHTC Investor to avoid “wasting” 1% of LIHTC?
- Master Tenant’s capital contribution to Landlord may be disproportionate to its interest.
- Master Tenant will have a large positive capital account at the Landlord. As a result, Landlord is unlikely to generate partnership minimum gain to support loss allocations to Federal LIHTC Investor during the 10-year LIHTC Credit Period.
  - May need to specially allocate non-depreciation deductions to MM or Master Tenant to preserve Federal LIHTC Investor’s capital account to avoid reallocation of LIHTC during the 10/11 year LIHTC Credit Period.

# Master Lease Pass-Thru



**<u>LANDLORD/PROJECT OWNER:</u>**

- Due to the Master Tenant's interest in Landlord, the Developer Fee and any other related party fees and rent under the Master Lease must be reasonable and reasonableness opinion from a qualified accountant required.
- Developer Fee must be repaid within 5-year HTC Compliance Period.
- Sponsor may have options to acquire property or LIHTC Investor's interest in Landlord at the end of the 15-year Compliance Period & 42(i)(7) ROFR (if applicable)
- Landlord is borrower of all debt and obligated to make debt service payments. Master Tenant has no liability on debt.

# Master Lease Pass-Thru

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**MASTER TENANT**:

- Owned 1% by Sponsor Affiliate as MM/GP and 99% by FHTC Investor during the 5-year HTC Compliance Period.
- FHTC Investor's interest in Master Tenant may "flip" down to as little as 5% following the end of the 5-year HTC Compliance Period.
- FHTC Investor may have option to "put" its interest in Master Tenant to Sponsor or MM following the end of the 5-year HTC Compliance Period.
  - Exercise of the put is within the sole discretion of the FHTC Investor and may not be compelled.
  - **Practice Point**: If the deal involves acquisition credits and a related party sale, need to take into account ownership of Master Tenant if put is exercised.

**MASTER TENANT**:

- Sponsor may NOT have an option to acquire FHTC Investor's interest after 5-year HTC Compliance Period.
- FHTC Investor will likely require:
  - A priority return (typically 1-3% of contributed equity);
  - Tax equivalency payments on any income allocated to FHTC Investor, including 50(d) income during such time as FHTC Investor is a member of Master Tenant; and
  - Financial Projections demonstrate a positive cash on cash return (1-2%) over the life of the investment assuming the put is not exercised.

# Terms of Master Lease

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- Master Lease will have a term of approx. 24 years.

- Landlord obligated to elect to pass-through FHTC to Master Tenant.

- Master Tenant will operate the property, collect rent from tenants, pay all operating expenses (some expenses, e.g., property taxes and insurance, may stay with Landlord), and enter into the property management agreement.

- Master Lease requires fixed annual base rent payments sized to cover debt service at Landlord and operating expenses at Landlord plus a cushion.

- Master Lease will likely include a supplemental rent feature pursuant to which most (but not all) of Master Tenant cash flow is paid to Landlord.

# Tax Considerations

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- Federal LIHTC Investor's Capital Account/Minimum Gain
  - Master Tenant will have a large positive capital account in Landlord and Landlord is unlikely to generate partnership minimum gain to support loss allocations to LIHTC Investor during LIHTC Credit Period.
  - May need to specially allocate non-depreciation deductions to MM or Master Tenant to preserve LIHTC Investor's Capital Account.
  - Related party debt likely not an issue given that no minimum gain (bad or good) is likely generated. However, if you are relying on the de minimis rule to avoid related party debt need to account for ownership of Master Tenant if put is exercised.

# Tax Considerations



- Related Party Acquisition
  - If you have a related party sale and are claiming acquisition credits, you need to take into account ownership of Master Tenant assuming put is exercised.

- Tax-Exempt Ownership/Use
  - GP/MM owned by one or more TE entities will need to elect to be taxed as a corporation and make a Section 168(h)(6)(F)(ii) election. Most FHTC Investors are not comfortable relying on qualified allocations.
  - If there is commercial space need to analyze whether subtenants are tax-exempt. Subleases to tax-exempt entities may be ok but need to be vetted.

# Non-Tax Considerations

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- FHTC Investor will require lenders (or at least hard money lenders) to enter into a Subordination, Non-disturbance and Attornment Agreement ("SNDA") pursuant to which lenders have the right to foreclose but cannot terminate the Master Lease during the 5-year HTC Compliance Period.
  - Certain lenders (HUD and Fannie Mae) will not agree to typical FHTC SNDA
- Removal/Repurchase – who is in the driver's seat?
- Sponsor guaranties will run to both LIHTC and FHTC Investors
- Equity pay-in – what are the conditions to FHTC equity installments? Is the building/district already listed on the National Register?