Year 15: Facing Off with the Aggregator

Newcomers Try to Toss Partnership Intent Out the Window

By David Davenport

The vast majority of relationships formed between real estate developers and tax credit investors in the Low Income Housing Tax Credit (LIHTC) industry are good, long-term relationships, generally guided by reasonableness and fairness, and also governed by complex partnership or operating agreements devised to achieve the parties' intent concerning their expectations, intended rights, benefits and obligations. However, we are all aware that some changes have been taking shape in the industry as investor limited partner interests have been changing hands, and control, or management of some of those interests are moving to what have become known within the industry as an Aggregator.

An aggregator—unlike a typical syndicator or investor that developers have worked with for years—is someone new to the general partner, who was not part of the initial transaction that led to the LIHTC partnership or affordable housing development, and who may view the partnership and its development as a financial instrument rather than an affordable housing real estate investment. As a result, once the development reaches the end of the compliance period, the aggregator aggressively may seek to dispose of the limited partner's interest in the project partnership or company to achieve a cash windfall inconsistent with the original tax credit investor's (and the real estate developer's) intentions and expectations and, in my experience, casts reason, fairness, good faith, intent and legal principles aside in hopes of extracting more financial return from the development than the tax benefits purchased.

As a trial lawyer with the law firm of Winthrop & Weinstine, P.A., located in Minneapolis, MN, I have for many years represented general partners and managing members in LIHTC disputes nearing or at the end of the compliance period. Over the past two years (since I published a piece called *Beware the Aggregator* in this publication), this representation has expanded to a dozen states and more than 60 project partnerships. This is obviously an industry concern. Today, perhaps more so than ever before, it is important for general partners and managing members in the LIHTC industry to be fully aware of the current marketplace dynamics that exist in and around Year 15 and the compliance period. Some recent cases I have been involved in provide warning signs of what can be in store.

For instance, I have been representing a nonprofit organization who is a general partner in three LIHTC project partnerships that were nearing the end of the compliance period in 2017, and my client is seeking to realize its thoughtfully negotiated buyout right that allows it to acquire the investor limited partnerships' interests in these partnerships based on a carefully constructed buyout process. This buyout process is found in many LIHTC partnership agreements syndicated years ago by a former syndicator. The buyout process requires a jointly selected appraiser to determine the fair market value of the investor limited partnerships' ownership interests in the project partnerships, and specifically instructs the appraiser to consider the following five factors: (1) rent restrictions; (2) limitations on the market for the ownership interests, which result from the lack of marketability, transferability and liquidity of those interests; (3) limitations on management and control; (4) limitations on the ability to require liquidation; and (5) any other reasonably applicable limitations on marketability and control. Clearly, the buyout process was designed to allow the general partner to acquire the investor limited partnerships' interests in the project partnerships based on the value of those ownership interests considering the on-going operations of the project partnerships, rather than assuming a sale of the affordable housing developments or liquidation of the project partnerships after the end of the compliance period. However, the investor limited partnerships disagreed and refused to transfer their ownership interests to the general partner unless the general partner agreed to make a substantial cash payment to the investment partnership based on an assumed, future re-syndication of the developments. As a result, my client commenced litigation to enforce its buyout rights. Ultimately, it was determined that the fair market value of the investor limited partnerships' interests in all three project partnerships was approximately $70,000, and through a

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summary judgment award from the United States District Court it was determined that the investor limited partnerships were not entitled "to subjectively disagree with the appraised FMV of their interests and then hold out for what they believed to be a more accurate price." As a result, the investor limited partnerships were adjudicated in breach of the partnership agreements and my client is entitled to recover the damages caused by these breaches.

In another case, I represented a managing member who exercised an option to acquire the interests of investor members in a LIHTC company after the end of the compliance period through another buyout process, which required a specified appraisal procedure designed to determine the fair market value of the ownership interests. The investor members refused to participate and select an appraiser as required by the operating agreement; thus, my client commenced litigation to enforce its option right. In response, the investor members, among other things, sued the individual members of the managing member in a separate suit and alleged a variety of claims, including breaches of fiduciary duty. As the litigation progressed and the appraisal process was completed, it was apparent that the investor members were seeking more than $1 million for their ownership interests based on the contention that the fair market value of their interests must assume the dissolution of the company and distribution of company assets to them as if a capital transaction was occurring at the company level. The court disagreed and confirmed, like my client argued, that a capital transaction was not occurring in the option process to determine the fair market value of the investor members' interests in the company. In doing so, the court also agreed with my client and determined that the fair market value of the investor members' interests in the company was less than $45,000. Shortly after this, in the retaliatory case filed against my clients in their individual capacity, the court entered an order pursuant to which the investor members made a monetary payment toward my clients' attorney's fees and costs.

In a third recent case, investor limited partners sought to have the fair market value of their ownership interests determined as if a capital transaction was occurring at the project partnership level. The court, however, held in favor of my developer client that a capital transaction is not triggered, nor implicated, when a general partner exercises and pursues an option to purchase investor limited partner interests because, in part, the transaction occurs outside of the partnership and involves the sale of personal property rather than partnership assets and dissolution thereof.

In sum, it remains my experience that the LIHTC industry continues to face significant Year 15 disputes and challenges, some as a result of the presence of an aggregator, and I believe that it is incumbent upon the general and managing partner community—for the sustainability of affordable housing—to remain diligent in pursuit of their Year 15 rights and benefits negotiated with the aggregator's predecessors. TCA

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