**Bay Forest Senior Apartments**

**Annapolis, Maryland**

This case study is an example of a negotiated early (year 12) buy-out of a limited partner and co-general partner by refinancing.

**Property Description**

Three story building in Annapolis, Maryland with 120 units in two adjacent buildings constructed in 1998. The property is occupied by senior citizens aged 62 years and older. It was originally financed with 9% LIHTC, a GSE first mortgage, and local CDBG from Annapolis and HOME funds from Anne Arundel County. The property performed well over the years and was in very good condition. A recapitalization was not really needed and the capital needs assessment identified minimal required repairs which were easily addressed with operating funds.

**Ownership Structure**

* General Partner was a joint venture between a for profit entity (49%) and HFA, a nonprofit organization (51%)
* Syndicator was a national for profit syndication firm
* The nonprofit organization did not have a Right of First Refusal
* The investor had the right to require a sale after year 15

**Operating and Financial Information**

Constructed: 1997-1998

Placed In Service: Spring 1998

Financing: GSE first mortgage with 10 year lock out and yield maintenance penalty

Original Sources:

FNMA 1st Mortgage $4,886,000 Rate: 9.0% Term: 10 yrs. Amort: 30 yrs.

Home – 2nd Mortgage $ 986,790 Rate: 2.0% Term: 30 yrs. Surplus Cash repay

CDBG – 3rd Mortgage $ 200,000 Rate: 1.0% Term: 30 yrs. Totally deferred

Equity- LP & GP $4,186,947

Total $9,260,237

Operating History: The property had a slow lease up and the for-profit general partner made nearly $500,000 in capital contributions through stabilization. The property performed well after stabilization and was current in payments on all the subordinate loans and syndicator asset management fees. The reserve for replacement had a balance of $190,000. The property did not have an operating reserve.

Physical Condition: 2010 and 2011 improvements to parking lot and interior lighting and accessibility upgrades had been made with proceeds of a CDBG grant and a Maryland DHCD energy grant to the nonprofit general partner. A capital needs assessment identified only a few minor repairs in conjunction with a refinancing.

Value: The property because of its location, condition, and market had significant value. An independent appraisal indicated the property had a value of $9.1 million with the LIHTC income restrictions in place and a market value of $17,600,000 without income restrictions.

**Proposal:**

The nonprofit general partner proposed buying out both the for-profit co-general partner and the investor limited partner. The parties agreed on a valuation approach based on a refinance using a 7% cap rate and an 80% loan to value. The assumption was that net proceeds from a refinance would be used to retire existing debt, pay the yield maintenance fee and distribute the balance to the exiting partners. This approach was definitely in favor of the nonprofit partner.

**THIS IS A BIG ISSUE AND IMPORTANT PUBLIC POLICY NOTICE:**

**The structure was successful in large part because public lenders with subordinate loans agreed to subordinate their loans to the new financing structure and did not require any pay down on their loans as part of the transaction.**

Cash flow for the six months prior to the refinancing was annualized and used as the basis for computing net operating income. The analysis is summarized below:

Net Operating Income $ 558,511

Gross Loan Proceeds from Refinance $ 6,350,000

Less: Closing Costs, prorations, payables $ (103,500)

Net Loan Proceeds $ 6,246,500

Pay off 1st mortgage balance $ (3,355,000)

Yield Maintenance Fee OUCH! (889,000)

$ (4,244,000)

Proceeds after debt pay off $ 2,002,500

Property cash accounts (includes RFR) 425,000

Less working capital + new RFR (150,000)

Less accrued asset management fee (15,000)

Proceeds available for distribution $ 2,262,500

Purchase of GP Interest 400,000

Purchase of LP Interest 1,862,500

**Financing the Transaction**

The new financing closed in April 2011 was provided through a Freddie Mac Capital Markets Execution (CMO). The loan had an interest rate 5.592% a term of 10 years and an amortization of 30 years. The loan amount was less than the analysis used to arrive at the payment for the partner interests. The final sources and uses are shown below:

Sources: Uses:

Loan $6,105,000 First Mortgage Payoff $4,135,789

HFA Contribution 122,100 GP Buyout 400,000

Proceeds from Property Cash 311,480 LP Buyout 1,700,000

Reserve for Replacement 200,000

Closing/Transaction Fees 102,797

Total Sources $6,538,580 Total Uses $6,538,580

**Maryland Policy Change**

A large portion of the closing costs related to a Maryland statute requiring payment of transfer tax on sale of ownership interests of 80% or more of an entity. The amount taxed was calculated based on the total value of the interests including property value, cash accounts, reserves, etc. During the 2013 General Assembly session, the statute was amended to limit the amount taxed on sale of partner interests in LIHTC transactions to the actual cash payment to the exiting partner.