ARLINGTON COUNTY, VIRGINIA

County Board Agenda Item
Meeting of November 14, 2020

DATE: October 19, 2020

SUBJECT: Request to Waive County Proceeds to Enable Purchase of Investor Interests at Parc Rosslyn and Columbia Grove by the Arlington Partnership for Affordable Housing (APAH)

C. M. RECOMMENDATIONS:

1. Approve the Arlington Partnership for Affordable Housing (APAH) request to waive the County's share of any proceeds from the capital distribution resulting from the release of the property accounts for Parc Rosslyn and Columbia Grove to enable APAH's purchase of M&T Bank's (Investor) Limited Partnership (LP) interests at these properties.

ISSUES: There are no known issues at this time.

SUMMARY: Staff supports APAH releasing a portion of its property accounts at Parc Rosslyn and Columbia Grove and waiving the County's share of any proceeds from the capital distribution needed to pay the Investor. This approval is needed because the Parc Rosslyn County loan agreement includes release of reserves in the definition of "Distributable Cash Flow." In order for APAH to pay the Investor to exit the partnership, APAH must use funds from its property accounts for both properties to pay the Investor. Once the Investor exits the partnership, exit taxes will stop accruing which will allow both properties to be refinanced in the future without additional financial obligation.

BACKGROUND: Parc Rosslyn is a 238-unit property with 138 market rate and 100 Committed Affordable Units (CAFs) for households earning less than 60% of Area Median Income (AMI). The property has a Virginia Housing (VH) mortgage of approximately $43 million and two Arlington County loans with a total balance of $10.5 million. In 2006, at the original closing for the project, M&T Bank, serving as the investor and LP of the partnership, provided an equity contribution of approximately $7.5 million. With these funds, APAH developed the property with Paradigm, who initially served as controlling manager of the General Partner.

Columbia Grove is a 14 building, 208-unit garden style property with 130 CAFs for households earning less than 60% AMI and 78 market-rate units. The property has a VH mortgage of approximately $13.5 million and two County loans with local and federal dollars with a combined

County Manager:
County Attorney:
Staff: Marie Randall, CPHD-Housing

total balance of approximately $10.5 million. The Investor's original equity contribution was $4.35M.

DISCUSSION: Parc Rosslyn opened in 2008 and this mixed-income property has experienced lower that projected revenue and higher than projected expenses. Specifically, the property experienced flat rent growth between 2012 and 2015, and although discretionary expenses increased by 2.5% annually, other expenses such as utilities and property taxes increased by 5.5% during this time. APAH has invested funds to improve operations at Parc Rosslyn, including replacing the management company in 2015, transitioning to a revenue management software, and completing renovations to the clubroom, lobby, and leasing office to increase revenue on the market rate units.

In 2013, with LP and lender approvals, APAH purchased Paradigm's interest of the controlling manager in the General Partner. During due diligence at the time of that acquisition, APAH discovered that the property had an imminent crisis in complying with certain provisions of the Internal Revenue Code which governed the allocation of the Low Income Housing Tax Credits (LIHTC). At that time, and after extensive review by APAH, CohnReznick, and the Investor, APAH contributed $5.5 million of its $6 million capital account to the LP to preserve the LP's capital account and therefore the allocation of the LIHTC credits.

In 2017, when the LP's capital account was again at risk due to higher than anticipated losses, APAH negotiated a $650,000, 2-year grant from VH, which created taxable income to the LP and reduced losses during 2017 and 2018. Additionally, the County approved an interest rate reduction from 4% to the Applicable Federal Rate (AFR) of 2.6% in 2017. While, this was important for the long-term viability of the property, it also reduced expenses and preserved the LP's allocation of tax credits through the end of the 10-year tax credit delivery period which concluded in 2018. To date, the LP's *capital account* is negative $161,000 while the LP's *tax capital account* is negative by $5.68 million. Going forward, all losses that are allocated to the LP will continue to increase the negative capital account which will generate additional exit taxes. As is typical for LIHTC partnership agreements, the owner of the project (APAH) is obligated to pay all of the LP's exit taxes in order to purchase the LP's interest. So in order for APAH to realize full ownership of the project and preserve its viability and affordability, the substantial, and continuously increasing, exit taxes must be paid.

Meanwhile for Columbia Grove, in 2016 the LP donated a portion of land that consisted of a parking lot and tot lot to APAH. The land was later developed into the Columbia Hills community, a high rise building with all 229 CAF units restricted to households at 60% of AMI. However, this donation triggered a known recapture event and resulted in recapture and loss of future tax credits. In connection with the donation, the General Partner, an APAH affiliate, made capital contributions totaling $1.75 million, of which $217,000 was paid to the Investor for reimbursement of recaptured and lost tax credits, $50,000 was added to the Columbia Grove replacement reserve, and the remainder was utilized for replacement parking and a tot lot.

In 2019, the LP's tax basis capital account went negative, which signifies that going forward, any losses taken against minimum gain will generate additional exit taxes. As with Parc Rosslyn, the LP's exit taxes will continue to increase and will be an obligation of the project and APAH until these LP interests are purchased.

APAH engaged CohnReznick and Walker & Dunlop in order to analyze values of the LP interest and different scenarios regarding costs and distributions for a buyout. In addition to any LP interest values that were calculated during these exercises, APAH recognized that all exit taxes would be additionally required to be paid to the LP for each property.

Negotiations with the Investor have been ongoing since April 2018. In connection with the early exits, APAH would provide an APAH corporate guarantee for ongoing tax credit compliance for the life of the compliance period, which expires in 2023 for Parc Rosslyn and 2024 for Columbia Grove. When taking exit taxes into account, the Investor calculated a $3.5M exit value for Parc Rosslyn and $783,000 for Columbia Grove, totaling $4.3 million which will continue to increase as exit taxes for both projects accumulate in future years. After APAH proposed lower amounts, the Investor presented a non-negotiable response of $2.3 million for exiting both properties. However, this transaction must be completed prior to December 31, 2020, or there will be additional taxes accrued and the exit price will change and need to be renegotiated.

Removal of the Investor in both deals will benefit current CAFs by helping to keep costs down at these properties which will help stabilize these communities in the short term and allow APAH flexibility for future refinancing and/or redevelopment. Redeveloping Parc Rosslyn could result in converting additional market rate units to, CAFs which would increase the number of those units and provide additional housing for families at 60% AMI or below and may reduce some of the losses the property has realized on the market units. Meanwhile, Columbia Grove's interest rate on the existing VH debt is 7.78% which is the highest in APAH's portfolio, and refinancing could result in significant savings for the project. The exit of the LP gives APAH more options to stabilize operations and cash flow at both properties.

Parc Rosslyn currently holds $2.6 million of cash and reserves (excluding mortgagor-required accounts, e.g. replacement reserve) and Columbia Grove holds $1.2 million of cash and reserves (excluding mortgagor-required accounts). APAH proposes using a portion of these cash and reserve accounts to purchase the Investor's LP interests. Specifically, $1.7 million of Parc Rosslyn's accounts and $600,000 of Columbia Grove's accounts would be used to support the $2.3 million purchase price and still retain the required amounts reserved by the first mortgages for each property. Although the County would not receive any portion of the proceeds from the release of these reserves in order to purchase the Investor's LP interests, there would also not be any need for additional County funds to support the transaction. Because the Parc Rosslyn County loan agreement includes release of reserves in the definition of "Distributable Cash Flow,", County Board approval is needed to waive the County's share of proceeds from the capital distribution due to the release of property accounts for Parc Rosslyn. Staff supports this approach.

PUBLIC ENGAGEMENT: On November 5, 2020, the Housing Commission will hear this item. A separate letter will be sent to the County Board with the Commission's recommendation.

FISCAL IMPACT: No new County funds are required in order for APAH to pay the Investor to exit the partnership. However, in order for this transaction to move forward at this time and without any additional County funds, the County must waive its share of proceeds from the capital distribution due to the release of property accounts for Parc Rosslyn. Both properties will retain mortgagor-required property reserves.