

insights

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LIHTC exit strategies: Right-sizing the loan

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.

The most logical long-term solution for a distressed and over-leveraged LIHTC project is a negotiated re-structuring or “right-sizing” of the debt owed to the lender. Such a right-sizing may be accomplished by a repayment of debt by the borrower and investors, a forgiveness of debt by the lender or a combination of both. While in theory this is the most logical solution, just like any settlement, it depends upon the parties’ assessments of their respective alternatives and their leverage for negotiating a deal that they believe is acceptable.

To better understand the key leverage points in negotiating a restructuring, readers should review [our previous post here](#). The primary issues include:

- How much debt reduction is necessary in order to reduce the debt to a level that the project will support? Note that in that if there is an interest rate swap in place, a right-sizing will likely trigger a swap modification fee (which in today’s interest rate environment may be significant).
- Does the limited partner have unfunded capital contributions that can be paid into the project
- Does the limited partner have an incentive and an ability to invest additional capital into the project? As we previously noted, a limited partners’ incentive to invest additional capital is largely a function of the value of future unearned tax credits on the project and the investor’s risk of recapture for tax credits already taken.
- Does the general partner have the incentive and ability to invest additional capital into the project?
- What are the lender’s options and does it have an economic incentive to participate in a re-margining by writing down a portion of its debt?

As an alternative to the lender writing down a portion of its debt, the debt may be bifurcated into an A Note (in an amount that the project can support) and a “soft” B Note (such as a note payable from the project’s excess cash flow or a sale of the project). This structure is likely to be more palatable to the lender than completely writing off a portion of its debt because it preserves the entire debt in the event that the economics of the project significantly improve or the borrower sells the project.

An A Note/B Note restructuring may seem like a logical and relatively simple solution. However, such a restructuring can present various challenges, including the following:

- The tax exempt status of the interest on the B Note may be adversely affected.
- A restructuring of a loan secured by a project involving so-called 4% LIHTCs may require a “reissuance” of the bonds, which will necessitate the involvement of bond counsel and will be more complicated and expensive than a restructuring of a typical loan.
- A restructuring will likely trigger a termination of any associated interest rate swap, which can result in significant swap modification fees.

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