



Commercial Financial Services Brief: Low Income Tax Credits Must Be Included in Debtor's Plan Valuation

October 18, 2012

In what it described as a novel issue of law in the Eighth Circuit (the Federal Circuit including Minnesota and North Dakota), the United States Bankruptcy Appellate Panel (BAP) for the Eighth Circuit recently ruled in *In re Lewis and Clark Apartments, LP* that, in a valuation of the debtor's low income housing project for purposes of its proposed Plan of Reorganization, the value of the low income housing tax credits (LIHTC) attributable to the project must be included. While this is a result lenders involved in the LIHTC industry may have assumed, it was not settled law in this Circuit.

The bankrupt debtor, Lewis and Clark Apartments, LP, owns a LIHTC apartment complex under a structure typical for these projects. The debtor itself is a limited partnership whose general partner, Lewis and Clark Partners, LLC, holds a 0.01% interest, while an investor entity, Investor Limited Partner-Centerline, LP, owns 99.97% of the debtor. Two other entities hold very small interests, including a state investment fund holding 0.01%.

In connection with proposing its Plan of Reorganization, the debtor asserted a value of between \$3.4 and \$3.5 Million for the project and in so doing attributed no value to the LIHTCs. The first secured lender, U.S. Bank, asserted a total value of \$5.3 Million, of which roughly \$3.3 Million was attributable to the project's assets, and the remaining \$2 Million arose from the value of the remaining tax credits. U.S. Bank is owed approximately \$6.3 Million by the debtor, and so the extent to which that claim is found by the Bankruptcy Court to be actually secured by collateral will significantly affect the Plan of Reorganization and the debtor's treatment of the U.S. Bank claim. The Bankruptcy Court had determined that the value of remaining tax credits did not affect the value of the debtor's LIHTC project, and U.S. Bank appealed that decision to the BAP.

The BAP reasoned that, in determining a market value for the project, both the rent and use restrictions encumbering the project and the tax credits arising out of the project need to be considered, since each has an effect upon the amount a willing buyer would pay for the project. The parties appeared to agree that, as the BAP pointed out, both the rent restrictions and the tax credits ran with the land insofar as they continue to encumber the project and benefit only parties with an interest in the project (or in an entity with interests in the land). The BAP said that a valuation which did not include both of these attributes affecting a LIHTC



project like the debtor's apartment complex would not accurately reflect the project's market value.

Both the Lewis and Clark Apartments, LP debtor, and the debtor in the Sixth Circuit *In re Creekside* bankruptcy case and appeal, argued that the right to the tax credits resided in the partners to the debtor, and not in the debtor itself, as an asset separate from the tangible project assets, and therefore the tax credits should not be included in a valuation of the project. Citing the *In re Creekside* case, the Eighth Circuit BAP made the distinction that, while the partners of the debtor may have agreed upon an allocation of tax credits through their various partnership agreements, the ownership of the tax credits remained with the owner of the real estate, the debtor itself. As a result, any future owner of the real estate, including the hypothetical willing buyer in a valuation, would also become the owner of the tax credits. The tax credits remain with the real estate.

As mentioned above, there is a state investment fund which holds a 0.01% interest in the debtor, and another creditor has claimed a security interest in the tax credits granted by that state investment fund. However, the BAP said that the tax credits were not an asset which could be owned separate from the apartment complex, and so a creditor cannot obtain a security interest in the tax credits only, without an interest in the real estate out of which those tax credits arise.

The ruling is a welcome clarification of the nature of tax credits as inseparable from the project property, and their affect upon LIHTC project valuations in bankruptcy and collateral situations. While lenders and lawyers active in the LIHTC industry might have expected the law to be as found by the BAP, it was sufficiently unsettled in our Circuit for this appeal to have occurred.