

REIT preserves affordable housing

By Bendix Anderson

New York — After a slow start, the Community Development Trust's (CDT) efforts to bring equity capital to preservation of older assisted housing is picking up speed.

Based in Manhattan, the for-profit real estate investment trust (REIT) is trying to make it feasible for owners to sell, and attractive for investors to buy into older properties. Its most recent success: the acquisition of Neptune Towers, an aging 334-unit Sec. 8 property in Lynn, Mass.

Many nonprofits would like to buy properties like Neptune Towers and preserve them as affordable housing, but there is a problem. Many of these properties were originally financed before the Tax Reform Act of 1986, using Sec. 8 and other programs and taking advantage of accelerated depreciation. Back then, equity investors were able to take tax losses on their developments far beyond the original investment. Now, if the properties are sold, much of the deferred taxes will suddenly come due. Few owners are willing to take that hit.

Had Neptune Towers been sold for cash, taxes would have swallowed up to 50% of the net cash from the sale, according to Gerrold Olanoff, counsel for Neptune Towers Associates, the former owners.

When CDT acquires a property, the sellers can trade their partnership interests in the real estate for units in CDT's Operating Partnership without paying taxes on the deal. Later, the seller can convert operating partnership units into REIT common stock or cash. That transaction will trigger exit tax, but because the seller can convert his units a little at a time whenever the time is right, he can work the conversion into his tax planning and potentially save a great deal of money.

Or the seller can hold his operating partnership units and pass them on to his heirs, as did one 93-year old investor in Neptune Towers. Provisions in the estate law will strip away much of the tax problem.

Also, operating partnership units can rise in value, a nice change from the increasing tax burdens investors face if they hold their properties. For a private REIT like CDT, the price of stock is generally established by the board of directors, based on the value of its real estate assets.

CDT has agreed to maintain Neptune Towers as affordable housing for an additional 20 years. This gives the seller some peace of mind, because CDT plans to hold property rather than selling it, which would create an unplanned taxable event. In addition, the deep-pocketed REIT has invested



The Community Development Trust has discovered a "very constructive and imaginative way to purchase a property," according to Gerrold Olanoff, counsel to the sellers of Neptune Towers.

more than \$1 million to make capital improvements to the property.

MassHousing provided debt financing for the deal and restructured the property's rents and financing under the HUD Mark-to-Market program.

"They put real equity on the table," said David Keene, manager of preservation and technical services for MassHousing. Keene hopes to do a lot more business with CDT.

With seed money from the Local Initiatives Support Corporation (LISC), Judd Levy created CDT in 1998. In 1999, Levy's company successfully raised \$31,750,000 in equity capital in a private placement with 18 institutional investors, including banks, insurance companies and others. Levy is president and chief executive officer.

The organization got off to a slow start, in part because of the overheated real estate markets of the last few years. "People not normally in the affordable housing markets were coming in and bidding up prices for older properties that they thought

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they could convert,” said David Abromowitz, an attorney with Goulston & Storrs of Boston.

It has also been difficult to find properties whose limited partners have a tax problem while the general partners care enough to engage in a complicated sale to solve the problem. Before the Neptune Towers deal, the REIT had only completed three purchases totaling

a little of 600 units, and those deals were closed since the fall of 2000.

Fortunately for CDT, the markets have cooled as the economy slowed and many competing buyers have realized how difficult it is, both economically and politically, to convert a property from affordable housing to market-rate housing in the Northeast.

Also, for the Neptune Towers deal, the general partner was also an equity investor in the property and had the same type of exit tax problems as the limited partner and the same

motives to sell to CDT. Many of the deals in which CDT is making progress have similar situations.

“I think it has wide appeal,” Abromowitz said. Older affordable properties—with a manageable number of partners that are fully depreciated and face a large exit tax if the property is sold—are good candidates. However, since the sale is a sophisticated transaction, it also requires a financially sophisticated seller. ■

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