


# City of Alexandria, Virginia

## MEMORANDUM

DATE: JUNE 19, 2008

TO: THE HONORABLE MAYOR AND CITY COUNCIL

FROM: JAMES K. HARTMANN, CITY MANAGER 

SUBJECT: CONSIDERATION OF LOAN INCREASE OF \$500,000 TO OFFSET A REDUCTION IN TAX CREDIT FUNDING FOR THE REHABILITATION OF BEVERLY PARK APARTMENTS

**ISSUE:** Proposed increase of \$500,000 to the existing permanent loan of \$1.5 million to Wesley Housing Development Corporation (WHDC) for Beverly Park Apartments, to offset a portion of funding shortfall due to a reduction in low income housing tax credit funding.

**RECOMMENDATION:** That Council allocate Housing Opportunity Fund monies and approve a \$500,000 increase in the City's current loan of \$1.5 million to WHDC for Beverly Park Apartments, as requested in Attachment I.

**BACKGROUND:** In 2005, the City made a \$1.5 million loan to Wesley Housing Development Corporation (WHDC) to help the non-profit housing organization acquire Beverly Park Apartments on Notabene Drive in the Arlandria section of Alexandria. In addition to Beverly Park, WHDC owns and operates two other affordable rental properties in Alexandria -- Lynhaven Apartments (28 units) on Commonwealth Avenue, and ParcView Apartments (149 units) on Holmes Run Parkway. The City provided loans to WHDC to assist with acquisition of all three of these Alexandria properties.

In April, 2007, at WHDC's request, the City approved a modification to its loan agreement for Beverly Park to convert the entire loan amount into permanent financing (\$300,000 was initially planned to be a short term "bridge" loan repaid of out tax credit funding and \$1,200,000 was meant to be long term) to accommodate greater rehabilitation needs and costs than had been projected in WHDC's first proposal. In its 2007 request, WHDC also asked to revise its original affordable housing plan to convert some of the property's 41 existing efficiency and one bedroom units into family sized units, resulting in a net reduction of affordable units from 41 to 33. WHDC's original proposal had been to retain all 41 units, while converting some into multi-bedroom apartments through construction of "bump outs."

**DISCUSSION:** The Beverly Park development received credits through VHDA's noncompetitive pool in late spring 2007, following two unsuccessful applications in 2005 and 2006. To begin the rehabilitation, plans and construction documents for the phased work were

finalized and submitted to the City. WHDC applied for and received a waiver from the City of the increased parking requirements that would be triggered by the level and cost of its planned rehabilitation. WHDC also worked with VHDA to resolve emerging issues related to newly implemented design and building criteria potentially impacting the scope of rehabilitation, and WHDC secured funding and a tax credit equity provider.

As WHDC prepared to close with its tax credit investor on the tax credit equity in early May, tax credit counsel for WHDC discovered a legal error in how the original purchase transaction had been structured by WHDC which rendered the project ineligible for low-income housing tax credits related to acquisition cost (but did not affect the tax credits awarded for rehabilitation). The loss of the acquisition credits reduced the planned tax credit equity to the project by \$900,000.

This discovery of the acquisition cost problem was particularly troubling to WHDC, as the same tax credit counsel had previously executed, for each of the three tax credit applications for this project, a VHDA-required letter stating a legal opinion that counsel had no reason to believe that the representations made as to the Development's compliance with or eligibility for exception to the eligibility requirements for acquisition credits were not correct. It is common practice that the applicant, VHDA and potential lenders and investors would rely on counsel's representations as expressed in the mandatory opinion letter. WHDC counsel, after providing the necessary assurances on three occasions, discovered its error only upon final closing of the credits. It should also be noted that WHDC's current President /CEO, Director of Real Estate Development, and Project Manager are all relatively new to the organization and were not involved in the structuring of the transaction.

The nature of the tax credit legal issue is as follows: Section 42 of the Internal Revenue Service Code, which governs low income housing tax credits, requires that in order to be eligible for acquisition credits, ownership of a property must not have been conveyed or transferred within the ten-year period prior to purchase. This prevents multiple sales between related or unrelated entities, which may artificially drive up value. The IRS Code has carved out some exceptions to the rule, including periods of ownership by government entities. Under certain circumstances, exceptions to the "ten-year rule" are also provided for transfers from and between non profit entities. In Beverly Park's case, WHDC created a for profit limited partnership entity to purchase and operate Beverly Park, with the expectation that credits would be obtained prior to or after transfer. Since WHDC purchased, operated and filed tax returns on the property in the name of Wesley Notabene Limited Partnership, for a period of more than eighteenth months prior to its credit award, it is not eligible for exceptions that might have been possible had it: (1) taken title in its own name, (2) taken title in the name of a wholly owned and non profit subsidiary, or (3) received its tax credit award within a shorter time after taking title to the property (Attachment II).

In addition to the \$900,000 reduction in tax credit equity from the acquisition credits due to the turmoil in the national financial markets, there was an additional loss of about \$200,000 in equity from a reduction in tax credit pricing, a phenomenon being experienced by most tax credit projects in the current market. The funding gap is further exacerbated by added construction costs of about \$175,000 associated with new VHDA rehabilitation standards.

In total, WHDC's funding gap is about \$1.3 million:

Loss of acquisition tax credits	\$0.9 million
Reduction in tax credit value	0.2 million
Increased construction costs	<u>0.2 million</u>
Total	\$1.3 million

It is proposed that this gap be closed in the following manner:

City Loan Increase	\$0.5 million
VHDA Loan Increase	0.5 million
WHDC Increased Equity <sup>1</sup>	<u>0.3 million</u>
Total	\$1.3 million

Even with the increase by \$0.5 million in the overall City loan amount to WHDC from \$1.5 million to \$2 million, and the planned reduction in units from 41 to 33, the amount of City subsidy per affordable unit is \$60,606 which is lower than the average City subsidy of \$107,875 per completed affordable/rehab unit. WHDC's revised pro forma indicates that repayment of the City loan can occur beginning in Year 16, with full repayment occurring around Year 41, or sooner if the property is refinanced before then. In the prior modification, repayment of the City loan was anticipated to begin around Year 9, although the repayment period still ran through Year 41. While all the details of the loan repayment terms remain to be worked out, it is staff's intent to seek repayment of the \$0.5 million extra loan amount as soon as feasible and earlier than Year 16 if possible.

On June 5, 2008, the Affordable Housing Advisory Committee discussed this issue and approved this \$500,000 loan increase.

**FISCAL IMPACT:** The source of the loan to WHDC will be \$500,000 from the Housing Opportunities Fund.

**ATTACHMENTS:**

- I. Letter requesting funding and HOF application
- II. Attorney letter regarding acquisition credit issue

**STAFF:**

Mildrilyn Davis, Director, Office of Housing  
Helen McIlvaine, Deputy Director, Office of Housing  
Eric Keeler, Division Chief, Housing Program Administration

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<sup>1</sup> WHDC increased equity will derive from its tax credit earned developer fee.

May 29, 2008

Mildrilyn Davis  
Director, Office of Housing  
City of Alexandria  
421 King Street, Suite 200  
Alexandria, VA 22314

RE: Beverly Park Additional Loan Request

Dear Ms. Davis:

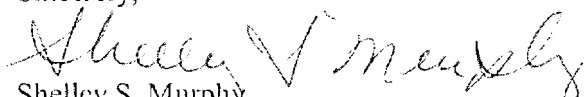
We would like to make an additional loan request of \$500,000 from the City's Housing Opportunities Fund for the Beverly Park project. We were recently informed by our attorney (see attached letter) that the Beverly Park project does not qualify for acquisition tax credits, which has created a shortfall of approximately \$1 million in our development budget. According to our attorney, when the project was acquired in October 2005 it was considered "placed in served" at that time. Because the project was not awarded low-income housing tax credits until June 2007, it exceeded the required timeframe to qualify for acquisition tax credits. The project still qualifies for rehabilitation tax credits, which are estimated at approximately \$2.4 million.

VHDA is willing to provide additional funding to cover a portion of the shortfall up to an additional \$500,000 to the project. VHDA is planning to submit the loan request to its Board of Directors for approval in June. In addition, our tax credit investor, RBC Apollo, is considering providing additional tax credit equity of approximately \$80,000. However, this is contingent on finding an investor that is willing to do so in a very volatile tax credit market.

We are anxious to start the much anticipated renovations at Beverly Park and are hoping to resolve this latest funding issue. If the loan request is approved by the City of Alexandria in June, we anticipate starting renovations by August 1<sup>st</sup>.

We appreciate any questions that you may have about the project. Please feel free to contact me at (703) 642-3830 ext. 212. We look forward to working with the City in completing this project.

Sincerely,

  
Shelley S. Murphy  
President/CEO

cc: Helen McIlvaine

**President/CEO**  
Shelley Murphy

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Virginia Peters  
1933-2004

CFC #60939  
United Way #8989

5515 Cherokee Avenue  
Suite 200  
Alexandria, VA 22312  
Phone: (703) 642-3830  
Fax: (703) 941-1724  
www.wesleyhousing.org

## Project Description

Beverly Park Apartments is located at 627 Notabene Drive (includes addresses 613, 625, and 641 Notabene) in the City of Alexandria, within an area known as Arlandria, adjacent to the Arlington County border and near the intersection of West Glebe Road and Mount Vernon Avenue. The neighborhood consists of garden apartments as well as scattered duplexes, townhouses, and single family homes along Notabene Drive and Old Dominion Boulevard, many circa the 1940s with some newer construction included. Currently, there are 41 one-bedroom units.

Wesley Housing Development Corporation (WHDC) proposes to preserve units at Beverly Park as rental under the Low-Income Housing Tax Credit (LIHTC) program. WHDC purchased the property in October 2005 at a cost of \$4,100,000. This acquisition also proposes a significant rehabilitation of the property. Through rehabilitation, the short term goal is to improve the appearance, condition, and habitability of the property for existing tenants, new families, and the Arlandria community at-large. With the implementation of the LIHTC program, the long term goal is continued affordability through restrictions ensuring rents will serve households at fifty percent (50%) and sixty percent (60%) of the area median income or less. Restrictions would be in place for a minimum of fifteen (15) years through the tax credit program, although WHDC has already agreed, through its first loan modification with the City, to a 40-year affordability restriction. Beside the City's loan and the tax credits, it is proposed that construction and permanent financing will be obtained through Virginia Housing Development Authority (VHDA), which requires that the restrictions extend to at least thirty (30) years.

The target population for Beverly Park will be households earning less than 50% and 60% of the area median income. The unit configuration will consist of 7 studios, 18 one-bedroom, 6 two-bedroom, and 2 three-bedroom units. There will be 7 units with rents at or below 50% AMI and 26 units at or below 60% of AMI. The proposed rents at 50% and 60% of AMI are \$759 and \$859 for studios, \$799 and \$959 for one-bedroom units, \$989 and \$1,199 for two-bedroom units, and \$1,099 and \$1,300 for three-bedroom units, respectively. The proposed rents have increased slightly from the rents submitted with the April 2007 loan modification request, however, these rents consistent with a market analysis that was conducted subsequent to the modification.

As in all WHDC properties, Beverly Park will accept Section 8 vouchers.

### Site Development Description

The general characteristics of Beverly Park Apartments include three parcels, totaling 41,975 square feet (.96 acres) with three, three-story brick apartment buildings built in 1940. Currently, there are 41 one-bedroom units. The apartments are small in average square footage and do not include many amenities or upgrades. As WHDC has owned the property over the last few years, management has determined the condition of the property and needs for rehabilitation are more serious than originally projected prior to purchase.

As approved with the April 2007 loan modification request, after the proposed rehabilitation, the overall total number of units will decrease from forty-one to thirty-three. The rehabilitation will combine several existing one-bedroom units to create larger two-bedroom and three-bedroom units. This will allow the project to better serve families that require larger unit sizes.

The total development costs are estimated at \$8,519,974 or \$258,153 per unit, which includes acquisition, rehabilitation and soft costs. See the financing section of this application for more discussion of funding details. The proposed rehabilitation exceeds the threshold percentage of value that triggers parking consideration. WHDC successfully applied for a Special Use Permit for a parking waiver that was approved by City Council in March 2008. WHDC will maintain the existing 28 on-site parking spaces.

### Project Design, Amenities, & Marketability

The primary project design proposed includes some interior unit reconfigurations within the existing three-story, brick, garden-style apartments at Beverly Park. This will create larger units with two and three bedrooms as well as additional bathrooms.

Due to the reconfiguration of the current one bedroom units to a mix of studio, one, two and three bedroom units, the apartments at Beverly Park will undergo a substantial gut renovation. Kitchens will be replaced with new refrigerators, stoves, microwave/exhaust units, dish washers, sinks, garbage disposals, base and wall cabinets, ground fault outlets, lights, VCT floors and base. Bathrooms will include new accessories, lavatories, vanities, water closets, tubs (or tub surrounds), shower heads, faucets, lights, medicine chests, tile floors, painted drywall, and ceramic tile bases. Where possible, existing hardwood floors are planned to be refinished.

Each unit will have a new individual heating and air conditioning unit with ductwork installed through the unit. Main and branch plumbing lines will be replaced. Electrical lines will be upgraded consistent with expected load levels and all new load centers will be installed. Each unit will have new entry doors, interior doors and windows throughout. The existing central hot water heaters for each building will be reused, and backup water heaters installed.

One unit on the first floor of Building 613 will be modified for handicapped accessibility. Building 613 will also house a newly created management office and laundry room to serve the apartment complex.

Exterior work will include power washing and repointing of the building where necessary. The existing parking lot will be repaved and restriped. The site will be landscaped with new shrubs and trees along the buildings and in front of the parking lot as a screen to the road. Exterior lighting will be installed.

The building will comply with Earthcraft Virginia guidelines, which ensures healthy living environments that reduce utility costs and protect the environment.

Beverly Park has significant marketability strength with the proposed improvements. As-is, the property has many advantages including location to transportation, employment, shopping, and leisure activities as well as its position in an increasingly expensive housing market with dwindling affordable options. With the proposed larger units and renovations, its market situation greatly improves providing more family-sized units and enhanced conditions in comparison to its immediate neighboring properties.

WHDC recently ordered an updated market study (February 2008) that considered the proposed renovations and unit mixes. It validated the marketability and stated Beverly Park was well-positioned as a tax credit property in this area.

### Funding Request and Project Financing

WHDC is requesting an additional \$500,000 from the City of Alexandria for the acquisition and rehabilitation of Beverly Park Apartments. The City already provided \$1,500,000 for the acquisition of Beverly Park in October 2005. In the original application, WHDC proposed that at conversion to permanent financing, the project would pay back \$300,000 and then \$1,200,000 would stay in the project long-term. Due to increased project costs, WHDC requested a loan modification in April 2007 (which was approved) to keep the total \$1,500,000 in the project long-term. Approval of this new request would result in a total permanent loan of \$2,000,000.

As part of the previous financing plan for the project, WHDC applied and received a reservation of Low-Income Housing Tax Credit from VHDA in June 2007. The reservation included a total of \$3,942,980 in tax credits (over 10 years). Based on this total, the total tax credit equity estimated for the project was \$3,351,201 ( $\$3,942,980 \times \$.85/\$1$ ). As previously referenced, WHDC was recently notified (see attached letter) by its attorney that the project does not qualify for acquisition tax credits, which were estimated at \$950,000 (over 10 years). As result, there is a \$950,000 gap in the current budget. The project still qualifies for rehabilitation tax credits which are estimated at \$2,401,201. Thus, WHDC is requesting an additional \$500,000 from the City of Alexandria to assist with covering the gap. In addition, WHDC has requested additional funding from VHDA and our tax credit investor, RBC Apollo. VHDA is willing to fund an additional \$585,000 for the project, which would consist of an additional \$500,000 in SPARC Match funds (if the City approves \$500,000 loan request) and \$85,000 in taxable bonds. WHDC has also requested additional tax credit equity from RBC Apollo (in the event the City or VHDA is unable to fund full requests). RBC Apollo is considering increasing equity pricing to approximately \$.87-\$.88, which would result in approximately \$80,000 in additional equity. Also WHDC will defer the majority of its developer fee to cover any additional shortfall.

Besides the \$1,500,000 loan from the City, the existing financing for the project includes \$2,500,000 from United Bank that was obtained in 2005 for the acquisition. WHDC initially received a short-term loan \$325,000 from the Housing Partnership Network (HPN) for the acquisition, but this was required to be repaid in March 2008. At construction loan closing, the \$2,500,000 from United Bank will be paid off.



### Partnership Description

As a tax credit property, Beverly Park will operate as a limited partnership for the purposes of ownership structure. WHDC has signed an agreement to have Apollo Housing Capital, LLC serve as the tax credit investor for the project. The proposed ownership structure will consist of the following ownership percentages:

#### Wesley Notabene Limited Partnership

General Partner:	Notabene Inc.	.009%
Limited Partner:	Apollo Housing Capital, LLC	99.99%
Special Limited Partner	Apollo Housing Manager, II	.001%

Currently, the ownership structure consists of WHDC as the limited partner (99.99% ownership interest). WHDC will be replaced by the new limited partner at construction closing.

### Timeline

The following represents a timeline for Beverly Park as of current conditions:

October 2005	Acquired property
June 2007	Awarded tax credits through VHDA noncompetitive pool
April 2008	Executed initial agreement with RBC Apollo (tax credit investor)
May 2008	Notified project does not qualify for acquisition tax credits
May 2008	Request additional funding from lenders
July/August 2008	Begin construction if increased loan amounts approved
July/August 2009	Complete construction and convert to permanent loan

### Developer Experience

Wesley Housing Development Corporation (WHDC), a leading nonprofit developer in Northern Virginia, has been providing affordable rental housing for families and individuals for over 30 years. The organization's mission is to: develop, own, operate, and maintain affordable housing and sustain quality communities for low- and moderate-income persons in Northern Virginia. This area includes Arlington, Fairfax, and Prince William Counties; Cities of Falls Church, Alexandria, and Manassas. WHDC combines affordable housing with supportive services to build strong, stable families and communities. Wesley Housing is the result of the efforts of a small group of citizens—led by former schoolteacher Virginia S. Peters—who identified the vast unmet housing needs in Northern Virginia in the 1970s. Since then, WHDC has sponsored the development of 20 communities in Northern Virginia with 1,500 housing units serving more than 15,000 low- and moderate-income residents over its history.

WHDC selects and purchases rental communities, oversees construction or rehabilitation, manages its properties, and rents its units at below market rates. Over time, WHDC has used a variety of public and private financing partnerships to achieve affordable housing goals including project-based Section 8, Section 811, the Low-Income Housing Tax Credit (LIHTC) program, and bond financing. LIHTC financing is the most common avenue for low- to moderate-income housing creation and is a proposed source for Beverly Park. To date, WHDC has developed six projects using the tax credit program. WHDC also has significant success with difficult-to-develop projects including housing for persons with HIV/AIDS as well as physical disabilities. In the City of Alexandria, WHDC acquired and renovated Lynhaven Apartments in 2002. WHDC acquired ParcView Apartments in 2006 and completed renovation in December 2007.

In addition to the financing, construction and management of housing, WHDC offers residents a comprehensive range of supportive educational and social services to contribute to family and community stability. Programs and services are offered through three site-based Community Resource Centers and one resident services center for seniors. Through the Centers, residents can access vital resources needed to secure living wage jobs and attain higher levels of self-sufficiency. Classes offered include English for Speakers of Other Languages, computer instruction, financial literacy, after-school programs, and summer camp.

WHDC has 45 employees including site-based property management staff. Its operations include real estate, property management, finance, fundraising, social services and family programs. The following are summaries of the staff experience for those personnel overseeing areas most closely related to the development and implementation of the Beverly Park project.

### Development Staff Experience

**Shelley S. Murphy** joined Wesley Housing Development Corporation (WHDC) as President/CEO in September 2007. A former senior executive with Verizon Communications, Murphy brings her organizational experience in strategic business growth to WHDC's award-winning affordable housing mission. During her 13-year tenure at Verizon, she helped create stronger associations throughout the company's broad network, including those with the federal government and Verizon's business partners. She turned declining revenues into double-digit revenue growth as President for Verizon Federal Markets. She was awarded the Verizon Chairman's Award in 2004 and 2005 for her proven results in operations and financial management, organizational change and development, and strategic planning. She holds a Bachelor's Degree in International Studies and a Master's Degree in Business Administration from Willamette University, Salem, Oregon.

**Kamilah P. McAfee** joined WHDC as Director of Real Estate in the spring of 2008. She will be directing and managing the implementation of WHDC's affordable housing development pipeline. She most recently served as a Development Associate with Forest City Washington in Washington, DC, supporting several large scale, mixed-use projects in Washington, D.C. Prior to her employment with Forest City Washington, she was the Director of Public Finance at the District of Columbia Housing Finance Agency (DCHFA), overseeing the origination, underwriting, structuring and closing of tax-exempt multi-family mortgage revenue bond transactions. She is an alumna of the Fellowship Program at the Center for Urban Redevelopment Excellence at the University of Pennsylvania. She holds a B.S. in Finance and New and Small Business Development from Georgetown University. She is currently a candidate for a Master's Degree in Business Administration at American University.

**Troy D. Cropper** serves as WHDC's Senior Project Manager for multifamily affordable rental properties located in Northern Virginia. As Senior Development Officer for the District of Columbia Housing Finance Agency, he underwrote multi-family loan transactions involving Federal Mortgage Insurance, Low-Income Housing Tax-Exempt Bonds, and Low-Income Housing Tax Credits financing. His other underwriting experience came from his tenures with M&T Bank, where he was responsible for multi-housing refinance loans under the Fannie Mae DUS program, and with Reilly Mortgage Group, Inc., where he underwrote HUD 221(d)(4) transactions in accordance with Multifamily Accelerated Processing (MAP) Program requirements. He holds a Master's of Public Administration Degree from the University of Delaware and a B.A. in History from Delaware State University.





WILLIAMS MULLEN

Direct Dial: 804.643.6465  
mbuseck@williamsmullen.com

May 14, 2008

**VIA EMAIL**

Shelley Murphy  
Wesley Housing Development Corp.  
5515 Cherokee Avenue, Suite 204  
Alexandria, VA 22312

**Re: Beverly Park**

Dear Shelley:

The following is a synopsis of the acquisition tax credit issue that has occurred with Beverly Park.

In 2005 Wesley Housing contracted to buy Beverly Park Apartments, and submitted an application to VHDA for 2005 acquisition and rehabilitation tax credits. Wesley did not win any 2005 9% credits for the project. In September, 2005, Wesley decided that it would buy the project in any event, with no tax credits in hand at that time, and without any assurance that it would ever receive tax credits. The property was purchased in a partnership entity in a structure that is recommended by the IRS for all such transactions related to non-profit entities. I told Wesley (just verbally) that there would be a potential issue with the acquisition credits.

In 2006, Wesley again tried to obtain tax credits for the project, but again was not successful. If it had received tax credits in 2006, there was a possibility that there could have been a reach-back to retain the acquisition credits.

Finally, in August of 2007, Wesley did receive tax credits on the property, through the non-competitive special pool for non-profits. As a result of that, Wesley approached investors and eventually obtained a term sheet from Apollo Housing. When I received the term sheet, I informed Apollo that I had concerns regarding the ability to use acquisition credits on this project. There are certain exceptions that may have applied, regarding non-profit entities and the use of the property, but those exceptions are somewhat unclear. After working through these issues with Apollo's counsel, and talking with the IRS, it was determined that none of the exceptions would work to allow the acquisition credits to be used on this project. The bottom

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Two James Center 1021 East Cary Street (23219) P.O. Box 1320 Richmond, VA 23218-1320 Tel: 804.643.1991 Fax: 804.783.6507  
www.williamsmullen.com



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May 14, 2008

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line is that the purchase of the property and the continuing use of the property in 2005 was a placement in service of the property at that time. Once the property is placed in service, there must be ten (10) years before acquisition credits are used, unless one of the exceptions applies. Even if there is a sale of the property through foreclosure or otherwise, no acquisition credits would be available until 2015. If tax credits had been in place in 2005, those would have worked.

One of the other issues was that some of the buildings on the property did not have any of their leases renewed, and were taken out of service once the leases expired. However, because the tax returns for this entity showed income for those units, and depreciation was taken on those units, the buildings were placed in service, and those potential exceptions will not work.

The only hope for the acquisition credits is that Congress is exploring eliminating the ten year rule for acquisition credits, but I do not know if that is likely to succeed.

Please call me with any questions.

Very truly yours,

Michael C. Buseck

MCB/ckw  
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