

# Impact of Revised Consolidation Guidance on LP Investments in LIHTC

In February 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2015-02, *Consolidation (Topic 810): Amendments to the Consolidation Analysis*. The amendments make targeted changes to the current consolidation guidance and are effective in 2016 for public business entities, including interim periods. All other entities have an additional year for transition—for fiscal years beginning after December 15, 2016, and for interim periods beginning after December 15, 2017.

The ASU modifies the evaluation of whether limited partnerships (LP) and similar legal entities are variable interest entities (VIE) or voting interest entities (VOE). The ASU eliminates both the consolidation model specific to LPs and the current presumption that a general partner controls LPs that are not VIEs. These changes are not limited to a particular industry; all reporting entities with a variable interest in other legal entities will need to re-evaluate their consolidation conclusions and potentially revise their disclosures, including investments in low-income housing tax credits (LIHTC).

*In many cases, the consolidation conclusion may not change as a result of this ASU. However, public business entities will need to update and document their new analysis and conclusions in 2016. All other entities have until 2017 to adopt the new standard.*

## Background

The LIHTC program is designed to encourage investment in construction and rehabilitation of low-income housing. An investor in a flow-through limited liability entity, such as an LP, that manages or invests in qualified projects receives tax deductions from operating losses and low-income housing tax credits over 10 years. There is little to no economic benefit from the investment other than the tax credits and tax losses expected to be generated. Under current accounting guidance, LIHTC entities usually are not consolidated; limited partner investors generally account for them as equity method investments.

An LIHTC investment can be made either through an equity investment as a limited partner of the operating entity that owns an individual qualified affordable housing project or through an investment in an LP that invests in multiple operating entities owning qualified affordable housing projects. In the most common structure, a general partner builds or renovates the housing project, issues the partnership interests and maintains and operates the project. The general partner typically holds a very small percentage of the equity investment in the partnership—as little as 0.01 percent—and receives a management fee; the limited partners hold the remaining interests and receive their share of income, losses, tax credits and distributions from the LIHTC project partnership.

The general partner (or in some cases, a related party of the general partner) may make certain guarantees to the limited partners, which could include:

- **Construction completion** — The general partner guarantees it will fund any amounts necessary to complete the project's construction if the partnership has insufficient funds.
- **Operating deficits** — The general partner guarantees it will advance the partnership funds, typically structured as loans, to pay any operating deficits of the partnership for a specified period (commonly three to five years).
- **Tax credits** — The general partner guarantees that, if the amount of the actual tax credits allocated to investors is less than the projected tax credits, the general partner will pay to the partnership for distribution to the limited partners an amount equal to the credit adjustment grossed up by any resulting tax liability of the limited partner.

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The partnership agreement establishes the terms of investors' exit. The general partner's purchase of the limited partner's investment is the most common form of exit. In a typical structure, the general partner cannot liquidate the partnership without the consent of the limited partners. In addition, the limited partners may or may not have the ability to remove the general partner without cause.

### Accounting Guidance



#### Scope Exceptions

The ASU affects all entities required to evaluate whether they should consolidate another entity. FASB carried forward existing scope exceptions related to employee benefit plans, investment companies and certain government organizations; therefore, all LIHTC investments will continue to be assessed for consolidation under the updated model.

#### Variable Interest

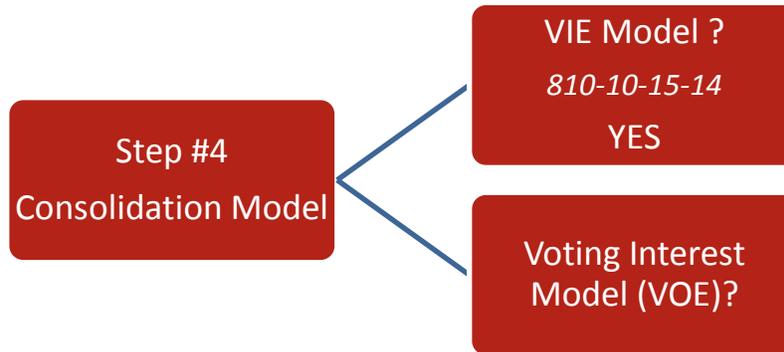
A variable interest is one that increases or decreases in value according to changes in expected cash flows from an entity's assets and liabilities. This can be a contractual or implied relationship between a reporting entity and a VIE that shares in the VIE's risks and rewards. After concluding an entity holds a variable interest, the next step in the consolidation assessment is determining if the partnership will be deemed a variable interest entity (VIE). The new standard does not change the definition of a VIE. VIEs do not have sufficient equity to fund their operations and, as a group, the equity holders lack any of the following characteristics:

- The right to receive expected residual returns
- The power to direct activities most significantly impacting the entity's economic performance
- The obligation to absorb expected losses

Under current U.S. generally accepted accounting principles (GAAP), a typical affordable housing partnership generally will be considered a VIE, since the general partner's investment is not considered substantive and therefore is not "at-risk equity." Further, limited partners lack sufficient decision-making authority because they can remove the general partner only for cause and have no control over operating decisions. As such, the equity owners at-risk, *i.e.*, the limited partners, lack the power to direct the activities that most significantly impact the VIE's economic performance. In some cases, the general partner's guarantees protect the limited partners' obligation to absorb the expected losses of the entity, resulting in the equity owners at risk lacking the obligation to absorb expected losses.

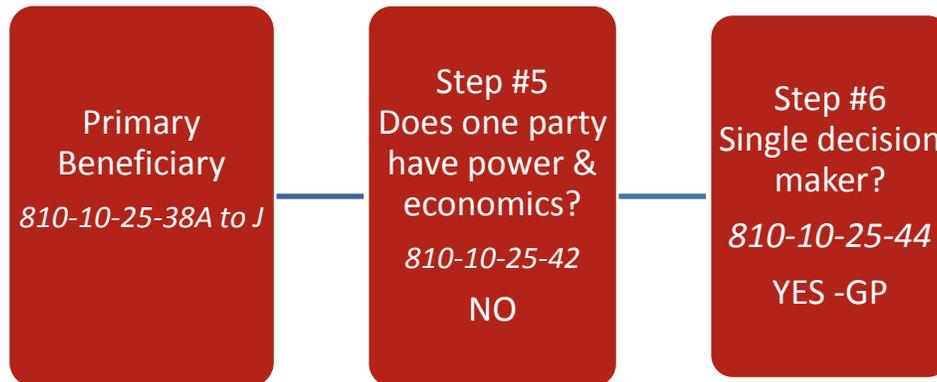
*Certain limited partnerships that were previously evaluated under the VIE model but are VIEs under 2015-02 amendments may be subject to additional disclosures if the reporting entity holds a "significant" variable interest in a VIE but is not the primary beneficiary.*

*Under both current guidance and the ASU 2015-02 updates, participants in LIHTC projects likely are holders of a variable interest in a VIE and therefore would not be subject to additional disclosure requirements due to the amendments.*



### Consolidation Model

The ASU modifies the evaluation of whether limited partnerships are VIEs or VOEs. To qualify as a VOE, an LP must provide limited partners with either substantive kick-out rights or substantive participating rights over the general partner. While the terms of each partnership agreement should be carefully evaluated, in a typical affordable housing partnership the limited partners may have protective rights but usually do not have substantive participating rights or substantive kick-out rights. As such, an affordable housing partnership generally will be considered a VIE under the new ASU, similar to existing GAAP.



### Primary Beneficiary

Under current U.S. GAAP and the new ASU, a decision maker is determined to be the primary beneficiary of a VIE and would consolidate if it satisfies **both** of the following power and economics criteria:

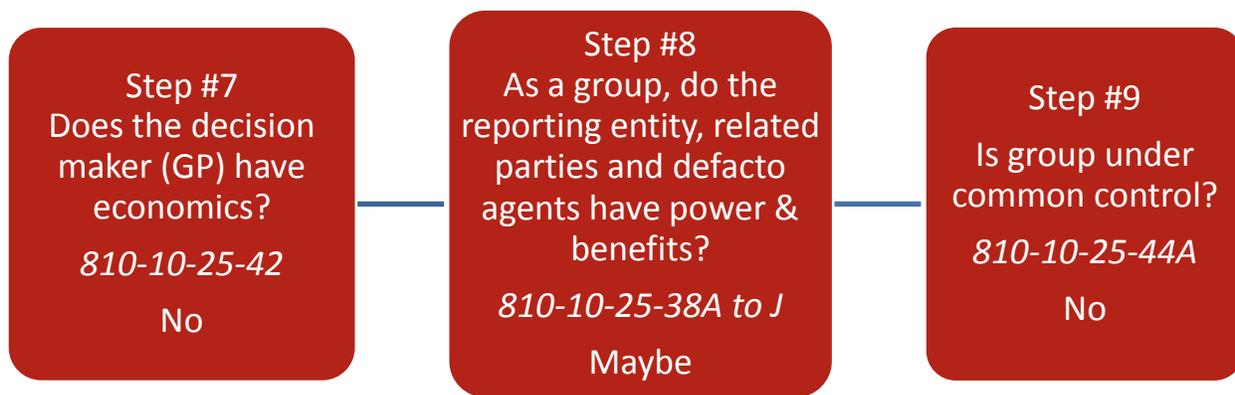
- The **power** to direct the activities that most significantly impact the VIE’s economic performance
- The obligation to absorb the losses of the VIE that could potentially be significant to the VIE, or the right to receive benefits from the VIE that potentially could be significant to the VIE—the **economics**

Typically, the general partner has the power to direct the most significant activities of the entity and receives operating fees. However, under the new ASU, when determining whether the general partner has benefits, it will exclude fee arrangements that are customary and commensurate. The ASU added an anti-abuse provision to prevent structuring opportunities by absorbing risk of loss through fee arrangements. Arrangements that expose the general partner to risk of loss, *e.g.*, for providing a guarantee, must be considered in the benefits analysis.

In a typical LIHTC structure, neither the general partner nor the limited partners have **both** power and economics.

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*Each structure is unique, and the facts and circumstances of each arrangement need to be carefully reviewed to determine the primary beneficiary.*



### Related Parties & De Facto Agents

The existence of related parties can significantly affect conclusions reached when analyzing whether VIEs require consolidation. The new standard incorporates related-party interests earlier in the analysis for a party with power (the LIHTC's general partner).

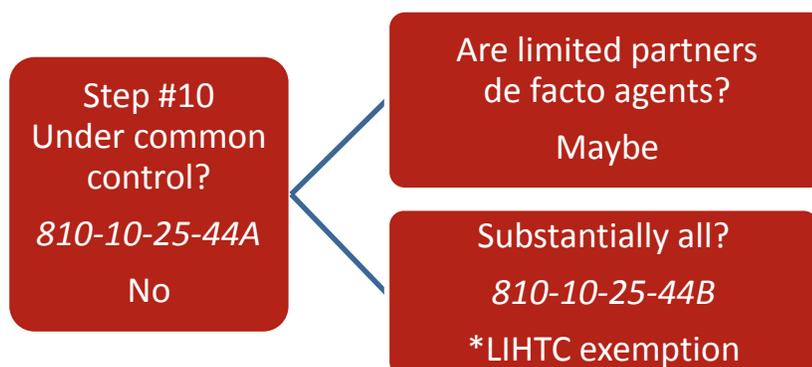
Sometimes, a reporting entity does not individually have the characteristics of a primary beneficiary, but when considered together with its related parties, the related-party group has characteristics of a primary beneficiary.

Under current guidance, a reporting entity performs the primary beneficiary power and economics tests on a standalone basis. Only if the reporting entity does not meet both tests on a standalone basis does the reporting entity consider related parties in the analysis. Under ASU 2015-02, a reporting entity that meets the power test on a standalone basis would include related-party interests in the economics analysis.

ASU 2015-02 includes de facto agents as well as related parties in the group assessment to satisfy characteristics of a primary beneficiary. Under the VIE model, a LIHTC agreement that prohibits a limited partner from selling, transferring or encumbering its investment without the prior approval of the general partner, may result in the limited partner being considered a de facto agent of the general partner. If the partnership agreement does not contain exit restrictions, the limited partner would stop the consolidation analysis here, concluding that consolidation was not required.

*In most cases, investors in LIHTC investments are not under common control with the general partner; therefore, the related party tie-breaker test would not apply.*

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If the general partner concludes that it individually, or as a related-party group **under common control**, doesn't satisfy the characteristics of a primary beneficiary, it still will need to consider whether the following are true:

- The general partner and one or more limited partners are related parties or de facto agents and as a group have the characteristics of a primary beneficiary
- If the above is true, substantially all of the VIE's activities are conducted on behalf of one of the limited partners that is a related party or de facto agent of the decision maker

If there are multiple limited partners in an LIHTC investment, no single investor benefits from substantially all the VIE activities and consolidation would not be required. Frequently in LIHTC structures, there can be a single investor holding all the limited partnership interests, and this investor would benefit from substantially all of the VIE's activities. However, ASU 2015-02 specifically exempts investors in LIHTC partnerships from having to assess whether they benefit from "substantially all" of the entity's activities. FASB was concerned that investors would be required to consolidate these partnerships despite not meeting the power test when they hold substantially all of the limited partner interests. This outcome would undermine [ASU 2014-01, Investments – Equity Method and Joint Ventures \(Topic 323\): Accounting for Investments in Qualified Affordable Housing Projects](#), enabling LIHTC investors to apply the proportionate amortization method.

*Entities that apply ASU 2014-01 are exempt from the "substantially all" provision of ASU 2015-02.*

### **Example – Determining the primary beneficiary of an affordable housing project**

*A general partner creates an LIHTC partnership that is determined to be a VIE. An unrelated community bank, Bank A, holds 99 percent of the equity interests and the general partner holds the remaining 1 percent equity interest. The general partner makes all decisions through its equity interest. The limited partner is considered a de facto agent of the general partner (and therefore a related party under the variable interest model) because the limited partner is restricted from selling its investment in the VIE without the approval of the general partner, but they are not under common control. The general partner concluded it does not have benefits that potentially could be significant to the VIE.*

#### **Analysis**

*The related-party group has power through the rights held by the general partner through its equity interest, and benefits through the limited partner investment. However, it's likely no entity in the group would consolidate the VIE because the limited partner is exempt from evaluating whether substantially all the activities of the VIE are conducted on its behalf.*

## *Impact of Revised Consolidation Guidance on LP Investments in LIHTC*

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This paper provides a framework for evaluating LIHTC investments under the new consolidation model. Each structure is unique, and the facts and circumstances of each arrangement need to be carefully reviewed to determine if an investment should be consolidated. While accounting and disclosures may not change, entities should update their consolidation analysis under the amendments in 2015-02. To learn more about how this new consolidation guidance affects your organization, contact your BKD advisor.

### Additional Resources

[FASB's New Consolidation Guidance](#)

[Accounting Guidance Update for Investments in Qualified Affordable Housing Projects](#)

### Contributor

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Exhibit A – Consolidation Analysis in Subtopic 810-10

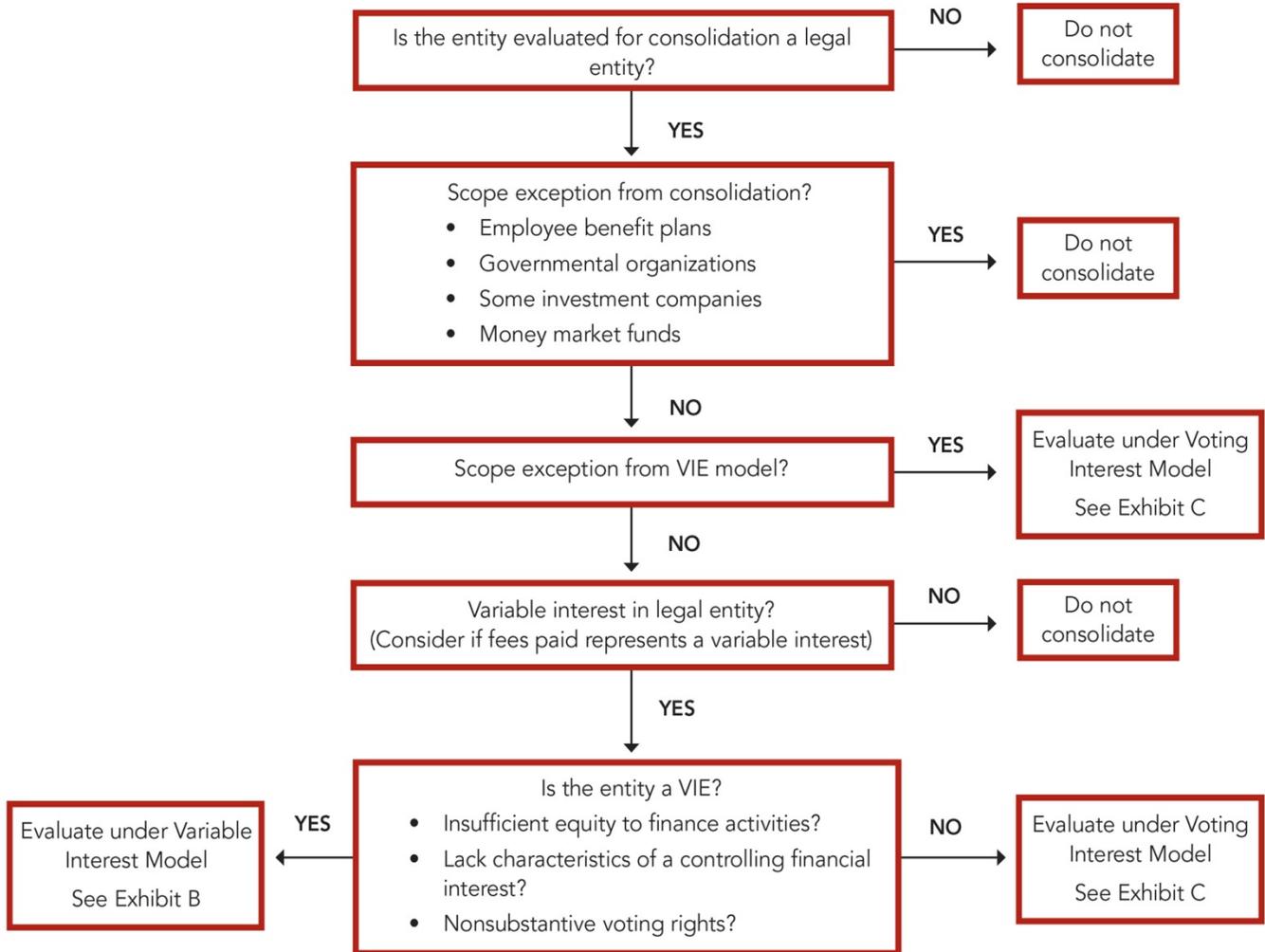


Exhibit B – Variable Interest Model

