Tax Credits and Mixed Finance Basics
For Boards and Executives

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Why would I want to do a Low-Income Housing Tax Credit (LIHTC) Deal?
So Why Use Tax Credits?

- All the COOL KIDS are doing it!!!!!
- It’s a Trick Question. I don’t need Tax Credits, because HUD will give us all the money we need...
- Tax Credits and Mixed Finance are a way to bring additional funding and private investment into your community. Using Tax Credits, you can provide new and revitalized Public Housing for your Community.
Role of Congress, State Agency and IRS

- **IRS and Congress**
  - Internal Revenue Code (IRC) §42
  - Treasury Regulations, Revenue Rulings, Private Letter Ruling, etc.
  - Recapture of credits

- **State Agency**
  - Qualified Allocation Plan and/or Regulations, Regulatory Agreement, Application
  - Allocates tax credits
  - Monitors tax credit compliance with IRS rules

- **HUD Handbook 4350.3**
  - Income and asset determination and verification
Traditional Sources of Funding

- Tax Credit Investors
- Tax Credit Equity
- Project costs
- Housing Authority

- U.S. Department of Housing and Urban Development
- Housing Authority
- Project costs
Awarding the Credit

- State housing agencies administer program
  - QAP (Qualified Allocation Plan)
  - Application Process
    - 9% - “Beauty Contest” credits - Determined on a point system
  - Application Cycles vary from state to state
- 4% Tax-Exempt Bond Credits
  - “Automatic Credit” if 50% of Aggregate Basis is financed with Tax-Exempt Private Activity Bonds
So Let’s Talk about the Investor….

- **What does the Investor Get?**
  - Generally 99 to 99.99% of Tax Credit and Tax Losses (Depreciation)
  - Some percentage of the Residual Value of the Property and Exit Taxes
  - Capital Account Maintenance Rules Apply
Typical LIHTC Structure

Sponsor/Syndicator

- General Partner
  - 1% or less of P&L and Credits

Investor
- Limited Partner
  - 99+% of P&L and Credits

Fund/Upper Tier Limited Partnership
- Limited Partner
  - 99+% of P&L and Credits

Lower Tier Operating Limited Partnership
- Developer
  - Developer fee

General Partner
- 1% or less of P&L and Credits
<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Project Costs</td>
<td>$10,700,000</td>
</tr>
<tr>
<td>Less: Ineligible Costs</td>
<td>($700,000)</td>
</tr>
<tr>
<td>Eligible Basis</td>
<td>$10,000,000</td>
</tr>
<tr>
<td>x DDA/QCT Adj.</td>
<td>x 130%</td>
</tr>
<tr>
<td>Adj. Eligible Basis</td>
<td>$13,000,000</td>
</tr>
<tr>
<td>x Applicable Fraction</td>
<td>x 85%</td>
</tr>
<tr>
<td>Qualified Basis</td>
<td>$11,050,000</td>
</tr>
<tr>
<td>x Applicable percentage</td>
<td>x 9.00%</td>
</tr>
<tr>
<td>Annual tax credits</td>
<td>$994,500</td>
</tr>
<tr>
<td>x Ten years</td>
<td>x 10</td>
</tr>
<tr>
<td>Total tax credits</td>
<td>$9,945,000</td>
</tr>
<tr>
<td>x Limited Partner %</td>
<td>x 99.99%</td>
</tr>
<tr>
<td>Limited Partner share</td>
<td>$9,944,006</td>
</tr>
<tr>
<td>x Price per credit</td>
<td>x 0.82</td>
</tr>
<tr>
<td>Purchase price</td>
<td>$8,154,085</td>
</tr>
</tbody>
</table>
What about the General Partner?

- The General Partner may retain any and/or all of the following:
  - Developer Fees
  - Contractor Overhead And Profit
  - Property Management Fees
  - Incentive Management Fees
  - Operating Cash Flow
  - Sale Or Refinancing Proceeds
General Partner,
Limited Partner.
How Long are Property Restrictions?

- Tax credits are claimed over 10 years, but:
- Tax credit compliance period is 15 years
- Regulatory agreement and IRC Sec. 42 govern during tax credit compliance period
- Extended use period runs from years 16 through 30
- Commitments are often made in tax credit and bond cap applications for longer affordability period than 30 years
Important Time Frames

- **Tax Credit Period**
- **Compliance Period**
- **Extended Use Period**

- PIS
- 10
- 15
- 30
Claiming the Tax Credits
How is Affordability Measured?

- Measured by median household income (Area Median Gross Income, “AMGI”)
  - Pertains to a nonmetropolitan county or a single/multi-county metropolitan area
  - Updated annually by HUD
  - Adjusted for household size
- Maximum household income for tax credit units is 60% of AMGI
- Often commitments made to provide more affordability (AMGI < 60%)
How are Rents Restricted?

- Maximum rents are set at:
  - 30% of qualifying household income per AMGI
  - Adjusted for “standard” household size assumptions
  - Reduced by allowance for utilities paid by tenants
- Maximum rents may change annually with annual update to AMGI by HUD
- Often rents are less than maximum due to market conditions
$30,000

Income Limit
(by household size)

Rent Limit
(by # of bedrooms)

$750
Four Basic Types of Affordable Housing

- New construction
- Acquisition and conversion of existing housing ("acq-rehab")

- Utilizing competitive “9%” tax credits and financed conventionally
- Utilizing non-competitive “4%” tax credits and financed with tax-exempt private activity bonds under the volume cap
<table>
<thead>
<tr>
<th>Financing Method</th>
<th>New Construction</th>
<th>Acquisition/ Rehabilitation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federally Subsidized (Tax Exempt Bonds)</td>
<td>4% credits</td>
<td>Acq – 4% Rehab – 4%</td>
</tr>
<tr>
<td>Non-federally Subsidized (Perm Loan)</td>
<td>9% credits</td>
<td>Acq – 4% Rehab – 9%</td>
</tr>
</tbody>
</table>
What Kinds of Projects Make Sense for HAs?

- New construction vs acq/rehab projects
- HOPE VI
- 9% vs tax exempt bond projects
Link Between Tax-Exempt Bonds and Tax Credits

- If project is financed with tax-exempt “private activity bonds” and
- Amount of bonds exceeds 50% of the sum of the land plus depreciable residential costs, then
  - Project is eligible for “4%” tax credits (and is ineligible for “9%” credits)
  - Amount of “4%” tax credits not limited per capita, but amount of bonds is subject to limitation (“volume cap”)
Tax-exempt bonds (Lower interest payments)

Public/gov’t Sector

Private Activity “Volume Cap”
Tax-exempt bonds (Lower interest payments)

Multi-Family Housing

Taxable bonds (Higher interest payments)

Private Sector
State

“Volume Cap” Tax-exempt Bonds

Greater of $90/person or $273,270,000 for 2009

(City/County)

Multi-Family Housing

Single-Family Housing

Student Loans

Docks and Wharves

Industrial Development

Airports
Two examples:

**California Volume Cap (2008)**

- 2008 State Debt Ceiling: $3,107,023,275
- Multifamily Housing reservation: $1,632,023,275
- Single-family Housing reservation: $700,000,000
- Industrial Development and Small Business reservation: $120,000,000
- Pollution Control and Recycling reservation: $430,000,000
- Student Loan reservation: $225,000,000

**Indiana Volume Cap (2008)**

<table>
<thead>
<tr>
<th>Program</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>IFA (Indiana Finance Authority)</td>
<td>9%</td>
</tr>
<tr>
<td>ISME (Indiana Secondary Market for Education)</td>
<td>1%</td>
</tr>
<tr>
<td>HCDA (Indiana Housing &amp; Community Development Authority)</td>
<td>28%</td>
</tr>
<tr>
<td>LIM (Manufacturing projects issued locally)</td>
<td>42%</td>
</tr>
<tr>
<td>LIC (Multi-family housing issued locally)</td>
<td>20%</td>
</tr>
</tbody>
</table>
50% Test for bond deals

Eligible Basis $7.6 mil

Tax Credit % 3.5%

Annual Tax Credits $266k

E.B. = $7.6 mil

$5 mil

Tax-exempt bonds plus Interest Earned

"Aggregate Basis"

Land plus Depreciable Basis
50% Test for bond deals

Eligible Basis: $7.6 mil

Tax Credit %: 3.5%

Annual Tax Credits: $266k

$3.8 mil

$133 mil

E.B. = $7.6 mil

50%

Land plus Depreciable Basis

Tax-exempt bonds plus Interest Earned

“Aggregate Basis”
### The 50% Test for Bonds

<table>
<thead>
<tr>
<th>50% Test</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Acquisition of Existing Building</td>
<td>$4,000,000</td>
</tr>
<tr>
<td>Total Depreciable Basis of Rehab (Eligible Basis)</td>
<td>$9,400,000</td>
</tr>
<tr>
<td>Total Depreciable Basis from Developer Fee</td>
<td>$1,600,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Total Aggregate Basis</th>
<th>$15,000,000</th>
</tr>
</thead>
</table>

| Tax-Exempt Bond Financing | $9,078,613 |

| Percentage of Aggregate Basis / | 60.52% |
## Comparing “9%” Tax Credits to Bonds with “4%” Credits

<table>
<thead>
<tr>
<th></th>
<th>“9%” Tax Credits</th>
<th>Bonds with “4%” Credits</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Financing Fees</strong></td>
<td>Low</td>
<td>High to very high</td>
</tr>
<tr>
<td><strong>Interest Rates</strong></td>
<td>Higher</td>
<td>Lower to very low</td>
</tr>
<tr>
<td><strong>Rents</strong></td>
<td>Lower (&lt; 50% AMGI)</td>
<td>Higher (60% AMGI)</td>
</tr>
<tr>
<td><strong>Financing Leverage</strong></td>
<td>Low to very low</td>
<td>High</td>
</tr>
<tr>
<td><strong>Amenity Costs</strong></td>
<td>Higher (due to competitive application requirements)</td>
<td>Lower</td>
</tr>
<tr>
<td><strong>Competition for Allocation/Reservation</strong></td>
<td>Very high</td>
<td>Low</td>
</tr>
</tbody>
</table>
Construction / Permanent Financing

- Conventional Debt
  - Soft Money
  - HOME funds
  - Tax Credit Equity
  - Deferred Developer Fees

Deferred Fee
Perm. Debt
Soft $$$
TC Equity
Let’s Wrap It Up...
Final discussion:

more questions and answers
For Further Information on LIHTC Housing

Find **FREE** tax credit resources at:

“www.taxcredithousing.com”

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