8TH Annual Economic Development Incentives Conference

Presented by VORYS VISTA SITE SELECTION

Speaker Info

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Affordable Housing Incentives 101

The basics. Mostly

Background

- Created by the 1986 Tax Reform to encourage the construction and rehabilitation of low-income rental housing
- Administered by the Treasury Department and allocated by State Agencies
- Contained in Section 42 of the Tax Code
- Emphasis on private sector involvement (i.e. developing managing and owning projects)
- Objective: to provide investor equity to reduce borrowed amounts and, therefore, debt service, thereby lowering rents
- Credit is a dollar-for-dollar tax reduction
- Credit amount is based on the cost of constructing or rehabilitating housing developments

Program Requirements

- Minimum percentage of LIHTC units (20/50 or 40/60)
- Minimum 30-year affordability commitment
- Maximum rents limited for LIHTC units
- Maximum income of households renting LIHTC units is limited
- Projects subject to IRS and State regulation/compliance

Who Can Use Credits?

- C Corporations can use credits and losses against ordinary income and taxes
- Limitations for "Closely-Held" Corporations
- Individuals limited under passive loss rules to approximately $8,750/year at the 35% marginal tax bracket rate

Partnership Tax Rules

- In order for an investor to take the LIHTC, it must be an owner of the entity that owns the building (usually the investor purchases a 99.99% interest in the partnership or limited liability company that owns the building). LIHTCs are not sold or otherwise transferable to an investor.

- LIHTC allocated in accordance with losses (depreciation deductions) – therefore, it is important that an appropriate amount of losses are allocated to the investor.

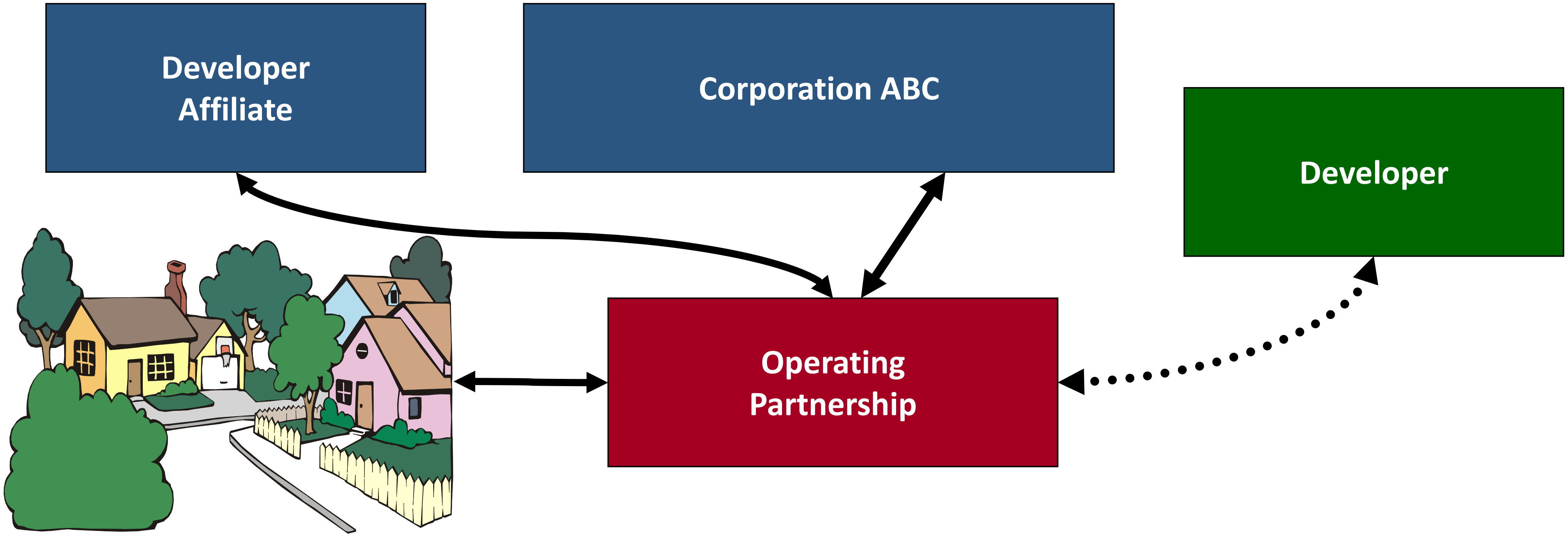
- Under the partnership tax rules, allocations of tax credits are not reflected by capital accounts.

- In order to be respected, tax allocations of the partnership must have substantial economic effect (maintain capital accounts and liquidate in accordance with capital accounts).

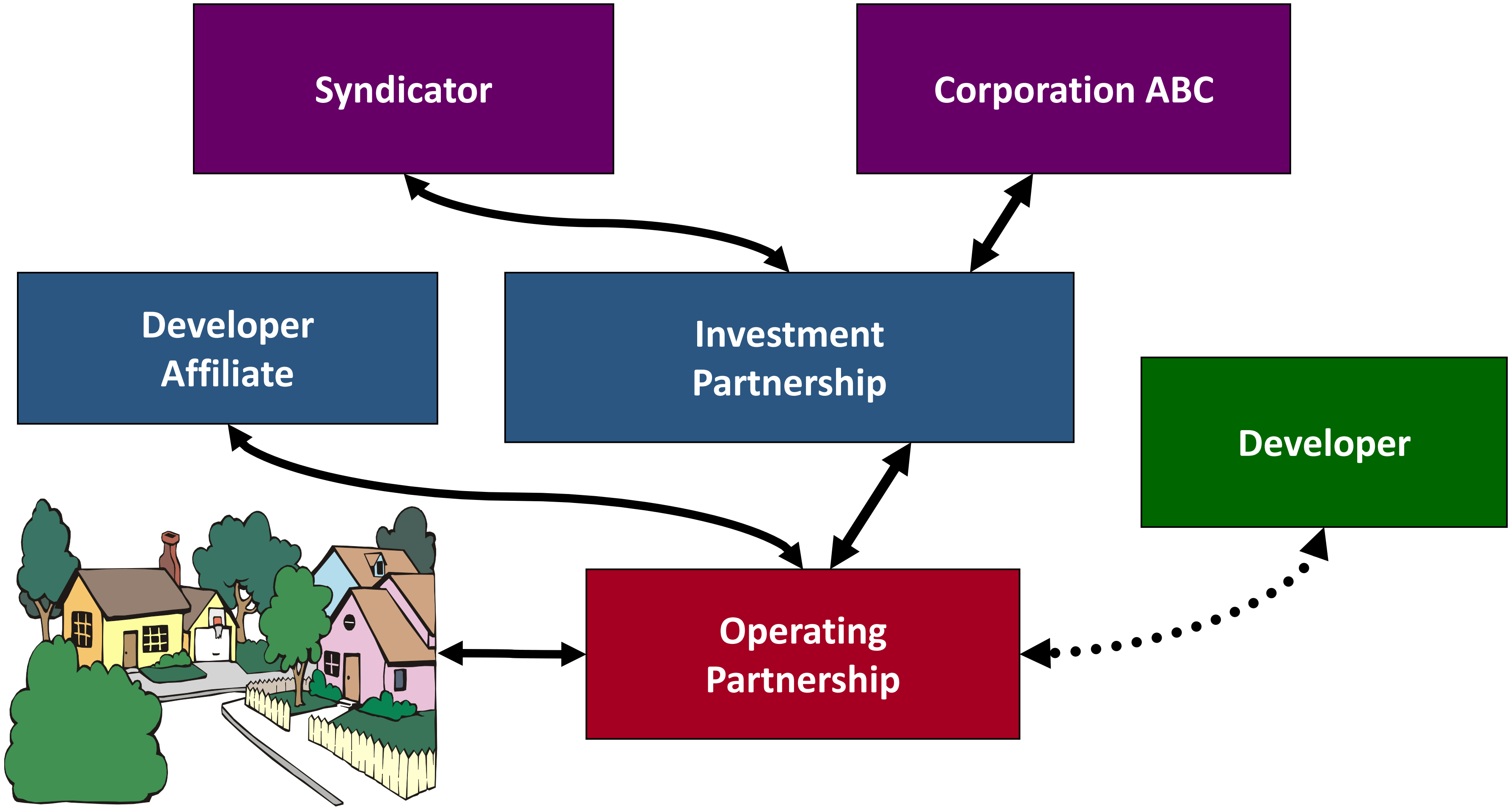
Common Investment Structures

- Direct investment structure
- Syndication Structure
  - Proprietary (single investor) funds
  - Multi-investor funds

Direct Investment Structure



Syndication Structure (Single Investor)



Key Business Terms

- Projects owned by limited partnership or limited liability company
- Limited partner or investor member generally is allocated 99.99% of tax credits, depreciation, losses and profits
- Limited partner or investor member makes capital contributions in multiple installments (generally 4 or 5), based on negotiated benchmarks
- Developer or affiliate of developer guarantees completion/stabilization, amount and timing of credits, and funding of deficits
- Investor protections (removal/repurchase)

Do we need bonds?

4% Credits vs. 9% Credits

- Qualifying for the 4% Credit (30% Present Value Credit)
  - Acquisition of existing building
  - Tax-Exempt Bond Financing – the 50% Test
  - Not as competitive but requires volume cap (which must be applied for)

- Qualifying for the 9% Credit (70% Present Value Credit)
  - New construction/rehabilitation if building is not "federally subsidized" (which means financed by tax-exempt bonds)
  - Very competitive

50% TEST(IRC Section 42(h)(4)(B):

- To be eligible for the full value of tax credits at least 50% of the aggregate basis (Aggregate Basis = Depreciable Basis + Land Cost + Building Cost) with tax exempt Bonds

- Bonds must remain outstanding until the placement in service

  - Placed in Service = when the building is ready and available for its designed use, but can be facts and circumstances

- 50% Test is measured at the end of the first taxable year of credit period

  - Cost overruns can be problematic as basis increases after bonds are issued

    - Requires more bonds to be issued

    - Reduction in developer fee

So What are Tax-Exempt Bonds?

- Must be issued by a political subdivision
- Interest paid to bondholders is exempt from federal income tax, resulting in lower interest rates to the borrower.
- There are a host of requirements that must be met for the bonds to qualify as tax-exempt

The Bond Team

- Issuer – States, Counties, Cities, Housing Agencies, Port Authorities
- Underwriter/Placement Agent – entity that finds the buyer for the bonds
- Bond Counsel – provides the legal opinion that the bonds are tax exempt
- Credit Enhancement
- Construction Lender
- Plus, everyone has a legal team

Monetizing Housing Credits: Understanding the Business Deal

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Permanent Transaction Capitalization

Sources	Amount	Per Unit
R4 Equity	$16,634,000	$99,012
Indiana State RTC Equity	$2,175,000	$12,946
R4CF Tax-Exempt Mortgage	$17,190,000	$102,321
IHCDA Second Mortgage	$750,000	$4,464
IHCDA Third Mortgage	$500,000	$2,976
NOI During Construction[1]	$250,000	$1,488
GP Equity	$100	$1
Reserves/Grants	$250,000	$1,488
Other	$0	$0
Deferred Developer Fee	$2,386,322	$14,204
Total	**$40,135,422**	**$238,901**

Permanent Transaction Capitalization

Uses	**Amount**	**Per Unit**
Land Acquisition	$131,950	$785
Building Acquisition	$459,309	$2,734
Hard Costs	$26,454,717	$157,469
Hard Cost Contingency	$1,314,423	$7,824
Soft Costs	$6,006,849	$35,755
Reserves	$591,600	$3,521
[Cash Developer Fee]	$2,790,252	
[Net Cash Developer Fee][2]	$615,252	
[Deferred Fee]	$2,386,322	
Total Developer Fee	$3,405,505	$20,271
Total	**$40,135,422**	**$228,359**

Permanent Transaction Capitalization

Sources	**Amount**	**Per Unit**
R4 Equity	$10,532,000	$210,640
State LIHTC Equity	$0	$0
Hard Debt	$0	$0
Soft Debt	$2,156,267	$43,125
NOI During Construction	$0	$0
Interest on Surplus Funds	$0	$0
GP Equity	$100	$2
Reserves/Grants	$0	$0
Deferred Developer Fee	$685,508	$13,710
Total	**$13,373,875**	**$267,477**

Permanent Transaction Capitalization

Uses	**Amount**	**Per Unit**
Land Acquisition	$17,800	$356
Building Acquisition	$62,200	$1,244
Hard Costs	$8,600,609	$172,012
Hard Cost Contingency	$905,828	$18,117
Soft Costs	$2,761,437	$55,229
Reserves	$76,000	$1,520
*[Cash Developer Fee]**	$264,492	
[Deferred Fee]	$685,508	
Total Developer Fee	$950,000	$19,000
Total	**$13,373,875**	**$267,477**

LIHTC Syndicator Considerations For Deal Analysis

1. **LIHTC Pricing** - The price assumed for the credits and the timing of the equity contributions are paramount for providing the investor a yield that will allow the deal to clear the market.

2. **Geography** - Certain investors will pay a premium to purchase product in areas where they have significant CRA needs. In multi-investor funds, it's important to have geographic diversity.

3. **Leverage** - Investors are wary of deals in which hard debt constitutes more than 65% of the capital stack.

LIHTC Syndicator Considerations For Deal Analysis

4. **Developer** - Developer experience and financial wherewithal are critical as LIHTC deals are complex and like all real estate, there is a chance of costs greatly exceeding the budget. Issues are guaranteed to arise in this complex program. Developers familiar with the program are more adept at finding solutions based on prior deals.

5. **Rents/Rental Subsidies** - Rents should have at least a 10% advantage to the market rents in the Primary Market Area. Section 8 and other rental subsidies are a benefit if the Section 8 contract is for at least 15 years and is project-based, not tenant-based.

6. **Construction Budget** - New construction numbers should conform to the data base for hard costs in the area. For a rehab, the hard costs should at least be $40,000 per unit and the post-rehab units should present as new product.

Thank You

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