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LIHTC 101 – The "Not So Basic" Basics

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What Is A Credit?

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Low-Income Housing Tax Credits, What Are They?

- Subsidy program for affordable rental housing
- Internal Revenue Service – Section 42
- Allocating Agency designated by IRS

How Do They Work?

- Owners and Investors eligible for reduction in federal taxes
- Received over 10 years
- Must remain affordable for 15 years (Compliance Period)
- IRS requires 30 year affordability (15 year Compliance Period plus 15 year Extended Use Period)

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How Do They Work?

- Enter into Limited Partnership for 15 years
- General Partner - .01%
- Limited Partner – 99.99%

What Do Tax Credits Finance?

- New Construction
- Rehabilitation
- Acquisition, if project qualifies
- Urban, Rural, Suburban
- Family, Senior, Special Needs

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Types of Credits

- 9% for Construction and Rehab
- 4% for Acquisition – see LIHTC 201
- 4% for Construction and Rehab – see LIHTC 201

- 9% rate is locked at 9%
- 4% is never actually 4% - rate is currently around 3.25%

9% for Construction and Rehab

- Credit is awarded to projects in accordance with the state's Qualified Allocation Plan (QAP)
- Allocating agency often holds funding rounds

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4% for Acquisition

Available for acquisition of buildings, but only if the project has been owned by the same owner for more than 10 consecutive years, with exceptions:

- Acquiring a building which is in foreclosure and had not changed owners in the previous ten years
- Acquisition a building which is owned by a nonprofit or government organization and had not changed owners in the 10 years prior to organization acquiring it

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4% for Construction and Rehab

- Available to projects using federal funds to cover the construction cost of the project
- HOME funds, Tax Exempt loans, CDBG funds

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4% Tax Credit Projects

- 4% Tax Credit Projects are financed through the sale of tax exempt bonds, typically at an interest rate below market.
- Tax-exempt loans must cover at least 50% of the total development cost.
- Project will be eligible for the 4% credit on a non-competitive basis.

How Do You Get Tax Credits?

- Developer applies to state housing credit agency (IN – IHCDA)
- Applications must meet underwriting criteria published in annual QAPs which detail selection criteria and compliance monitoring rules

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Creating a Good Application

- Firm loan commitments
- Local support
- Financial feasibility
- Low income targeting
- Development amenities
- Long term affordability
- Development team experience

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Eligible Basis and Determining Equity

Determining Eligible Basis

- Depreciable costs related to the building(s):
  - Building acquisition
  - New construction or rehabilitation, including common areas
  - Site improvements
  - Construction financing fees including interest
  - Developer fee
  - Attorney fees, architect fees, accounting fees
  - Building permits, impact fees, sewer/water fees

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Costs Not Included in Eligible Basis

- Land
- Commercial space leased to a business
- Permanent financing fees
- Tax credit application/monitoring fees
- Syndication fees
- Marketing and lease-up costs
- Reserves (operating, replacement, services)
- Amenities charged to the residents (carports, laundry machines, storage)

Development Budget

Land	**$925,000**
Construction cost	**$6,334,000**
Architectural fees	**$135,000**
Market study, Survey, Permits	**$55,000**
Cost certification, attorney, insurance	**$195,000**
Construction fees, interest, title	**$375,000**
Developer fee, third party reports	**$1,200,000**
Operating reserve, perm loan & tax credit fees	**$422,500**
Total Development Cost:	**$9,641,500**
Non-Basis items (land)	**($925,000)**
Other Non-Basis items (perm loan fees, reserves)	**($422,500)**
Total Eligible Basis:	**$8,294,000**

Calculating the 9% Credit

Eligible Basis	**$8,294,000**
Applicable Fraction	**X 100%**
120% Basis Boost	**X 120%**
Qualified Basis	**$9,952,800**
Tax Credit Rate	**X 9.00%**
Annual Tax Credit	**$895,752**
10 Years	**X 10**
Total Tax Credits	$8,957,520
Times 99.99% allocated to Investor	99.99%
Total Credits to Investor	$8,956,624
Investor Price	**X 0.88**
Tax Credit Equity:	**$7,881,829**

Calculating the 4% Credit

Eligible Basis	**$8,294,000**
Applicable Fraction	**X 100%**
120% Basis Boost	**X 120%**
Qualified Basis	**$9,952,800**
Tax Credit Rate	**X 3.24%**
Annual Tax Credit	**$322,471**
10 Years	**X 10**
Total Tax Credits	$3,224,710
Times 99.99% allocated to Investor	99.99%
Total Credits to Investor	$3,224,388
Investor Price	**X 0.88**
Tax Credit Equity:	**$2,837,461**

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Debt Calculation

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Income and Rent Restrictions

- Goal of the program is to create affordable rental housing.
- HUD believes a household should pay no more than 30% of their annual income for rent and utilities.
- Tax Credit program defines low to moderate households as earning 60% of the Area Median Income adjusted for household size.

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Income and Rent Restrictions

- A 4 person 60% household earns $40,980. The maximum rent and utilities they should pay is $1,025 a month ($40,980 x 30% = $12,294 / 12 = $1,025)
- Rent limits change annually and are published by HUD.
- When you have rent restrictions the potential for debt service is limited which means you cannot borrow enough to develop your building.

Example Income Restriction

County- 2017 AMI $68,300				
# of Bedrooms	**AMI Target**	**# of People in Household**	**Max. Income**	**Max LIHTC Rents & Utilities**
Efficiency	60%	1	$28,740	$718/mo
One Bedroom	60%	1.5	$30,780	$769/mo
Two Bedroom	60%	3	$36,900	$922/mo
Three Bedroom	60%	4.5	$42,630	$1,065/mo

Rent Projections

# BR	# Units	Rent	Total/Mo	Total/Yr
0	5	$550	$2,750	$33,000
1	11	$600	$6,600	$79,200
2	10	$625	$6,250	$75,000
3	24	$675	$16,200	$194,400
Total	50		$31,800	$381,600

Proposed Operating Expenses

Expense	Annual	Per Unit
Administrative	$46,000	$920
Repairs & Maintenance	$37,500	$750
Utilities	$41,750	$835
Property Management	$26,670	$533
Real Estate Taxes	$38,100	$762
Insurance	$20,000	$400
<u>Miscellaneous</u>	<u>$14,980</u>	<u>$300</u>
Total	$225,000	$4,500

Debt Calculation

Total Potential Income	$381,600
Minus 7% vacancy	$(26,712)
Net Rental Income	$354,888
Minus $4,500/unit Expenses	$(225,000)
Minus $300/unit Replacement Reserve	$(15,000)
Net Operating Income	**$114,888**
After Debt Service Coverage of 1.15 114,888/1.15	$99,903
Monthly Debt 99,903/12=8,325 Interest rate at 6%; 30 Year Term in Months: 360	$8,325
Mortgage Amount	**$1,388,576**

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Filling the Gap

Development Budget

Total Development Cost	$9,641,500
Total Mortgage Amount	$1,388,576
GAP	$8,252,924

Development Budget

Total Development Cost	$9,641,500
Mortgage Amount	$1,388,576
LP Equity Amount (9%)	$7,881,829
GAP	**$371,095**

Development Budget

Total Development Cost	$9,641,500
Mortgage Amount	$1,388,576
LP Equity Amount (4%)	$2,837,459
GAP	**$5,415,465**

Filling the Gap with Soft Financing

- There are other ways to fill the financing gap than borrowing money:
    - HOME
    - CDBG
    - AHP
    - Historic Tax Credits
    - Other: Philanthropy, other grants, etc.

Filling the Gap with Soft Financing

- HOME Investment Partnerships Program (HOME)/CDBG
  - HUD provides grants to State and municipalities
  - Finances affordable housing – rental or home ownership
  - Awarded Annually
  - Flexible – grants, loans, loan guarantees, etc.
  - Rental Restrictions: 80% of Ami – falls in line with LIHTC deals

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Filling the Gap with Soft Financing

- Affordable Housing Program (AHP)
  - Federal Home Loan Banks provide grants for affordable housing
  - Up to $500,000
  - Competitive process
  - Apply with a member bank

Filling the Gap with Soft Financing

- Historic Tax Credits
  - 20% of qualifying expenses are eligible
  - Building must be certified as a historic structure by National Park Service
  - Strict guidelines to rehab requirements
- State Tax Credits

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Filling the Gap with Soft Financing

- Other Ways:
  - Philanthropy
  - Other Grants
  - Tax Increment Financing
  - GP Capital Contribution

Deferring Developer Fee

- If you still have gap in financing, the final "buffer" is deferring the payment of your developer fee
- Must be paid through cash flow by year 10-13 to be included in eligible basis
- This is often how cost overruns are handled prior to closing or during the development

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Syndication

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Syndication

- What is a syndicator?
- What role do they play?
- What is an investor?
- What role do they play?

Investing in Affordable Housing Using Tax Credits

General Partner .01%

Cinnaire Fund Manager Entity

Investment Fund

Limited Partner 99.99%

Corporations
(Financial Institutions, Insurance Companies, etc.)

Tax Benefits

Development Partnerships

General Partner
.01%
Joint Venture For-Profit and Non-Profit Sponsor

Limited Partner
99.99%
Investment Fund

General Partner
.01%
Non-Profit Sponsor

Limited Partner
99.99%
Investment Fund

General Partner
.01%
For Profit Sponsor

Limited Partner
99.99%
Investment Fund

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Why do investors use syndicators?

- Buffer between developer and investor.
- Manage risk for investor.
- Lack of staff expertise/capacity

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How are syndicators compensated?

- Fees
- Load

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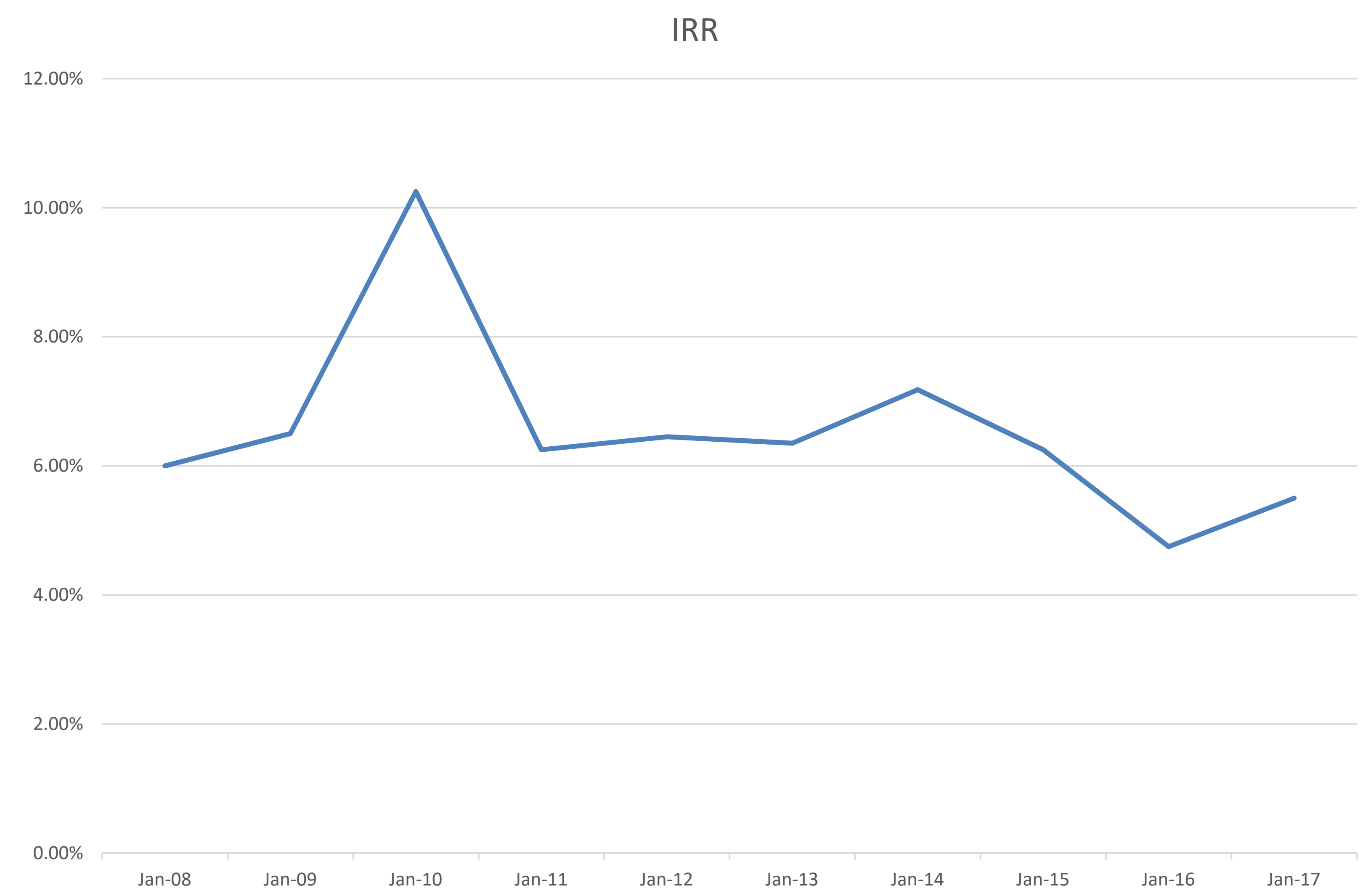
How does change in market affect deals?

- IRR over time vs. pricing over time


IRR
12.00%
10.00%
8.00%
6.00%
4.00%
2.00%
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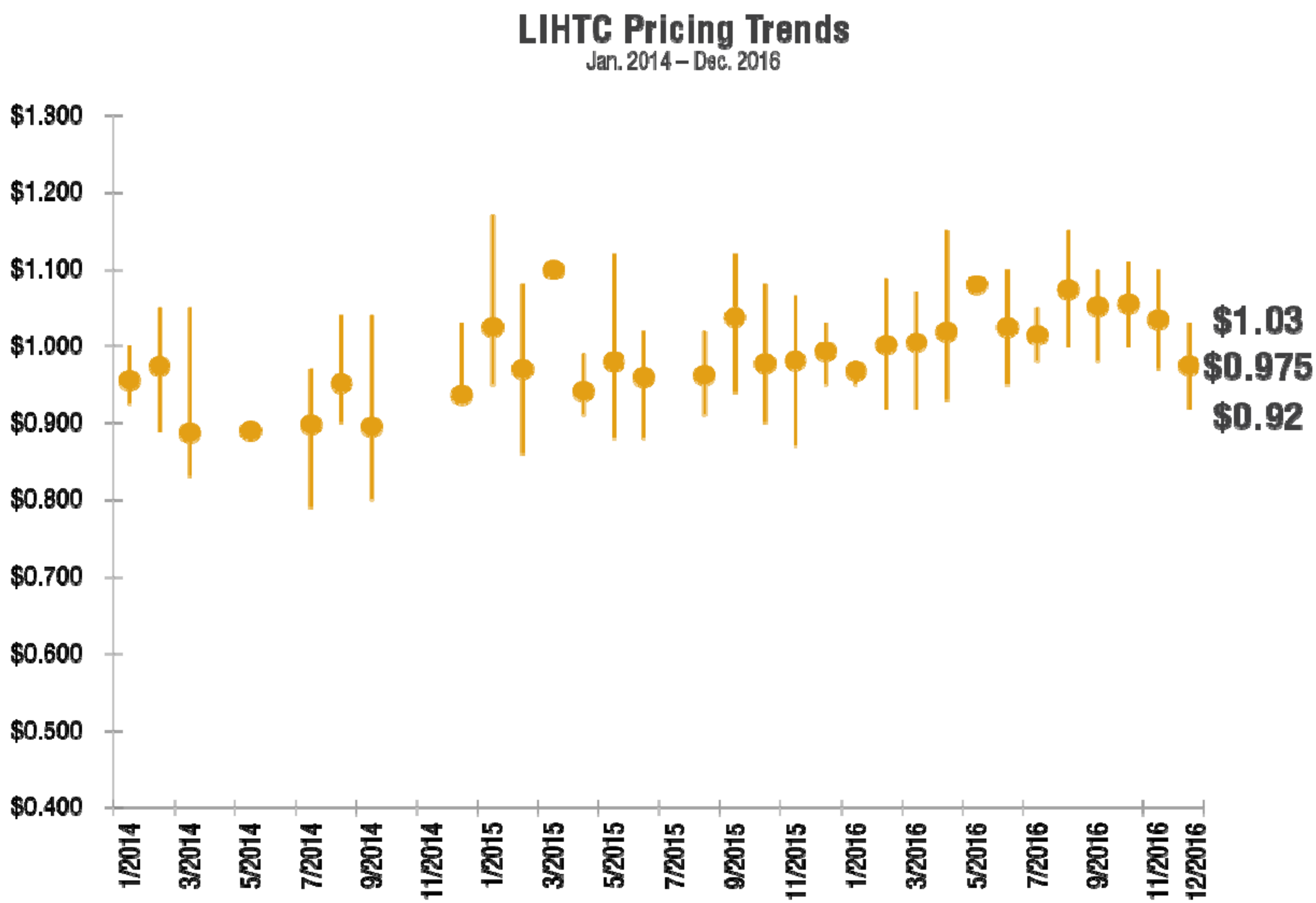

Source: Novogradac & Company LLP

Real Estate Market

- Targeted Tenants
- Neighborhood Advantages
- Transportation/Expressways
- Employment Possibilities
- Schools/Daycare
- Shopping/Services

Financing

- Owner Equity
- Investor Equity
- Debt
- Secondary Financing
- "Soft" Loans or Grants

Support System

- Tenant Referral
- Management Company
- Credit Counseling
- Institutions:
  - Mental Health
  - Medical
  - Rehab Clinic