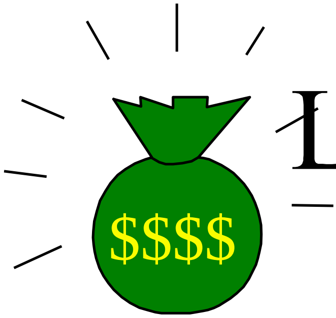
Understanding Low Income Housing Tax Credits

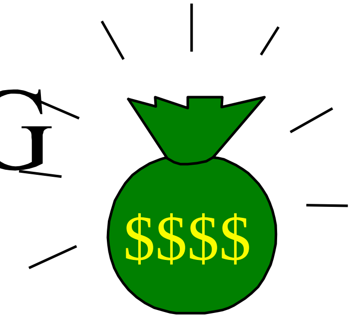
American Association of Homes and Services for the Aging 39th Annual Meeting and Exposition

Presented By

Debbie Burkart



LOW INCOME HOUSING TAX CREDITS



- **Established by Congress in 1986 to encourage private investment in construction and rehabilitation of affordable housing**
- **Since 1987, the program has produced over 1,625,000 units or approximately 125,000 annually**
- **Largest single funding source for affordable housing production in the U.S.**

A Tax Credit is ……

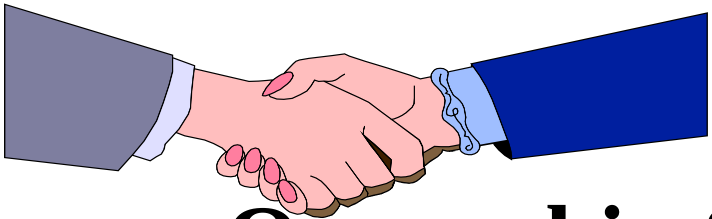
- **A dollar for dollar deduction against the tax liability of an individual or corporation**
- **Not a federal subsidy**

LOW INCOME HOUSING TAX CREDITS

- State Housing Finance Agencies receive from the IRS an annual allocation of $1.25 per capita
- States develop allocation plans and Sponsors/Developers apply for credits
- Credit amount to a project is based on construction costs incurred and begins when units are occupied by low income families
- Most types of housing can be developed with the LIHTC but must be <u>residential and rental</u>

WHAT IS A LIHTC SYNDICATOR?

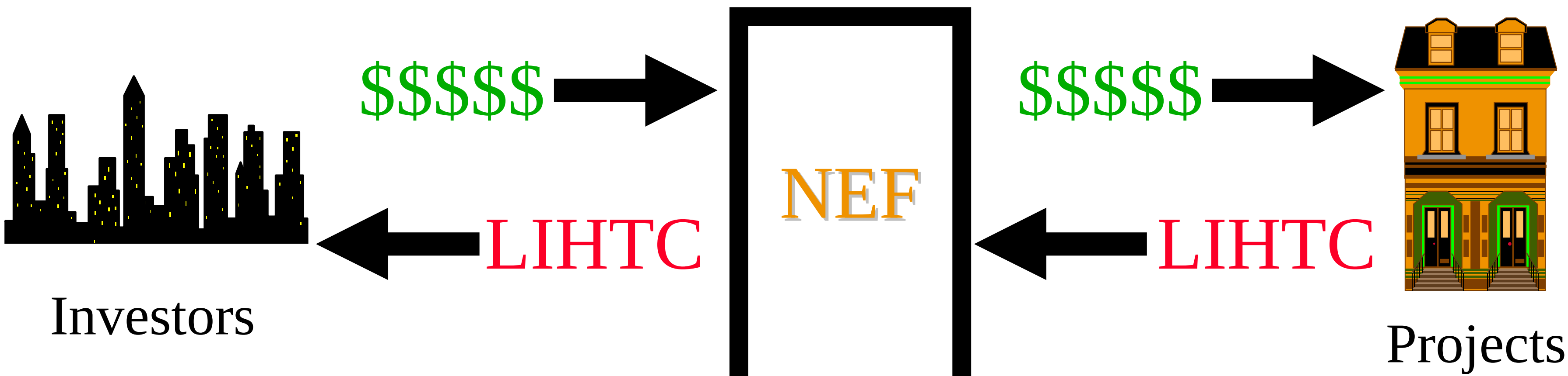
- Syndicators such as NEF provide equity in exchange for a 99.99% interest in the LIHTCs and the operational losses that flow from a given project
- Investors receive direct credit against federal tax liabilities for their investment in low income housing



Ownership Structure - The Limited Partnership

- Sponsor acts as General Partner (GP)
  - GP oversees development team and construction, obtains funding, applies for LIHTCs, coordinates supportive services, maintains LIHTC compliance
- Syndicator acts as Limited Partner (LP)
  - LP forms a partnership with the GP and provides equity in exchange for a 99.99% interest in the LIHTCs and the operational losses that flow from a given project

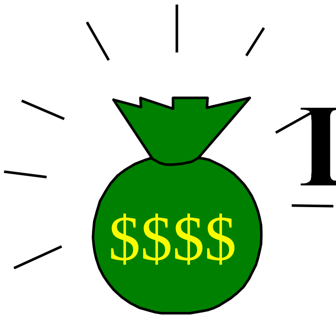
LOW INCOME HOUSING TAX CREDITS



LOW INCOME HOUSING TAX CREDITS

FOUR TYPES OF TAX CREDITS

1. **Rehab/New Construction LIHTC**
   – "9%" of eligible basis taken over 10 years
2. **Acquisition LIHTC**
   – "4%" of eligible basis taken over 10 years
   – only with rehab and only 1 owner in last 10 years, special exceptions may apply



LOW INCOME HOUSING TAX CREDITS

FOUR TYPES OF TAX CREDITS (Cont'd)

3. LIHTC awarded with Tax Exempt Bond application

- Must finance over 50% of project
- Automatic 4% credit taken over 10 years

4. Historic Rehab Credit

- 20% of basis taken in first year only
- Different IRS section

What is “Basis”?

How much tax credit is there?

CALCULATING TAX CREDITS

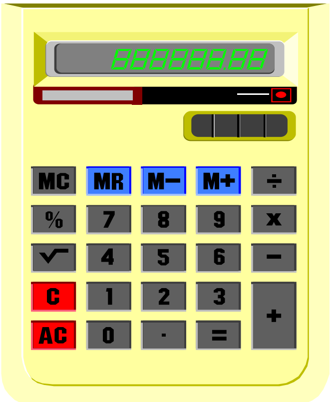
Housing Credit Terms

- **Eligible Basis**
- **Credit Rate**
- **Application Fraction**
- **Qualified Basis**
- **Basis Boost**

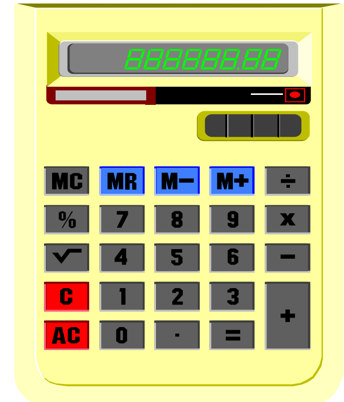
LOW INCOME HOUSING TAX CREDITS

What is eligible basis?

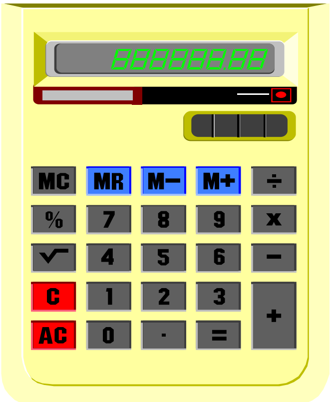
- Eligible Basis **is the value of the costs incurred by a taxpayer to make a residential property ready for its intended use. For new construction it's all the costs associated by building the property; for renovation, it's all the costs associated with the repair of building.**
- **An estimate of the** Eligible Basis **anticipated to be incurred during your project's development period will be performed in order to apply for tax credits**



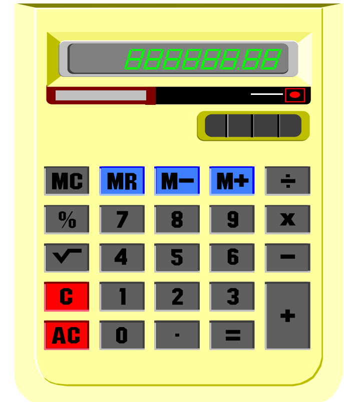
What costs count as “basis”?



- **Construction costs**
  - including construction period costs such as loan interest, real estate taxes, water & sewer charges, and insurance
- **Architect’s Fees**
- **Environmental surveys**
- **Relocation Expenses**
- **Title and Recording Fees**
- **Appraisals**



What doesn't count in "basis"?

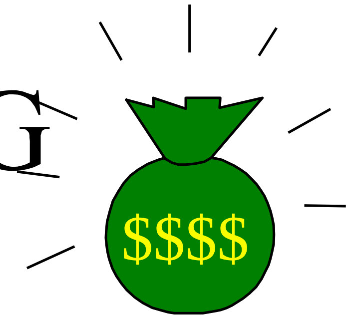


- Land Acquisition
- (Reserves) up front operating, replacement (or rent-up reserve and escrow accounts)
- Permanent Mortgage Fees
- Partnership Organization Costs (Legal)
- Marketing Expenses
- Syndication Costs

LOW INCOME HOUSING TAX CREDITS

- **Credit Rate**
  - **Published monthly by the IRS**
  - **Rates are multiplied by the adjusted qualified basis to determine the annual LIHTC amount for which the project is eligible -- must "lock in" your rate**
  - **Rehab credit rate is between 8% and 9% and the actual rate will yield 70% PV over 15 years. The discount rate is the federal rate and that varies monthly, which is why the credit can change monthly.**

LOW INCOME HOUSING TAX CREDITS



- Qualified basis **is the amount of eligible basis (less any federal financing) that is attributable to the low income units**
- Qualified basis **is found by multiplying adjusted eligible basis by the lesser of (1) the percentage of low income units in building or (2) the percentage of floor area attributable to low income units in the building**

Sample LIHTC Calculation

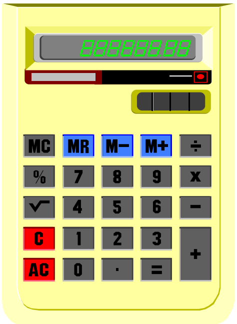
TDC	$5,000,000	
minus	1,050,000	ineligible costs
equals	3,950,000	eligible basis
times	100	% qualified units
equals	3,950,000	qualified basis
times	8.35	% credit rate
equals	$ 329,825	annual credit amount for ten years

LOW INCOME HOUSING TAX CREDITS

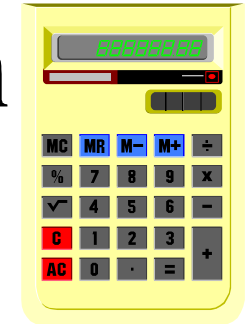
- **Basis Boost -- You can increase your qualified basis by up to 130% if your project is located in**
  - a qualified census tract (more than 50% of the residents earn less than 50% of median income)

  OR

  - a difficult to develop area (where costs are far above the national average)
  - HUD publishes a list QCTs and DDAs eligible for basis boost annually



Sample LIHTC Calculation Using Basis Boost



TDC	$5,000,000	
minus	1,050,000	ineligible costs
equals	3,950,000	eligible basis
times	100	% qualified units
times	130	% basis boost
equals	5,135,000	qualified basis
times	8.35	% credit rate
equals	$ 428,773	annual credit amount for ten years

Use of Federal Funds with LIHTC's

- **Any federal funds used for construction must be subtracted from eligible basis. This is to avoid double federal subsidy**.
  - Tax exempt bonds are included as federal financing
  - HOME and CDBG do not function as federal funds
- **Rather than subtracting federal dollars you can take <u>4% credit</u> on entire eligible basis.**

LIHTC Requirements

- **Rent and Income Restrictions**

EITHER

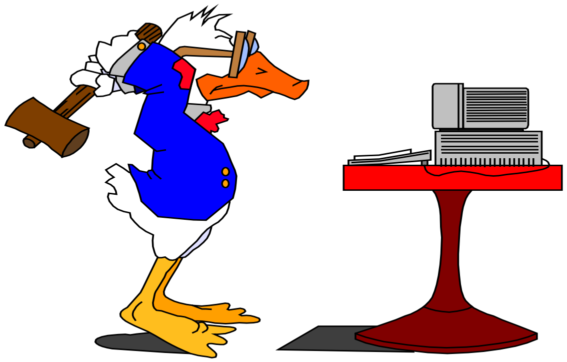
- 20% of units must be reserved for families earning 50% of area median income (AMI) **OR**
- 40% of units reserved for families earning 60% of median income

And there's more....

- Rents for low income units must not be more than 30% of targeted household income

LIHTC Requirements

- Leases must be for a minimum of six months
- Rent and income restrictions last for at least 15 years, often longer
- **Minimum Rehab Standard**
  - The owner must perform a minimum amount of rehab the value of which is equal to the greater of $3,000 per unit or 10% of the building's adjusted basis.



LIHTC Requirements

- Cost Certifications
  - 10% Carryover
  - 8609 Filing
- Initial tenant income certification (TIC)
- Annual compliance and monitoring
- Record keeping

LIHTC Requirements

- **Recapture. If the project does not maintain the rent and income restrictions, the investors will be subject to recapture 1/3 of the tax credits taken and interest on these tax credits.**
- **Because of this recapture, you must maintain detailed records demonstrating the rent and income of each low income tenant. These must be certified annually.**

LIHTC USES

"Flexible $ Money"

- Construction Costs
- Operating Reserves
- Social Service Reserves
- Replacement Reserves
- Reduces other sources of debt
- Developer Fee

General Partner Responsibilities

- Coordinating Sources of Funding
  - construction, rent subsidies, social services
- Managing the Development Team
- Balancing Social Service and Asset Management Issues
- Tax Credit Reporting and Compliance

Show me the credits! Where do we begin?

- Your role as sponsor, service provider, developer/co-developer?
- Use an experienced development team
  - Consultant
  - Property Management Company
  - General Contractor
  - Architect
  - Tax and Real Estate Attorney w/ LIHTC expertise
  - Tax Accountant with LIHTC expertise

How do we apply for LIHTCs?

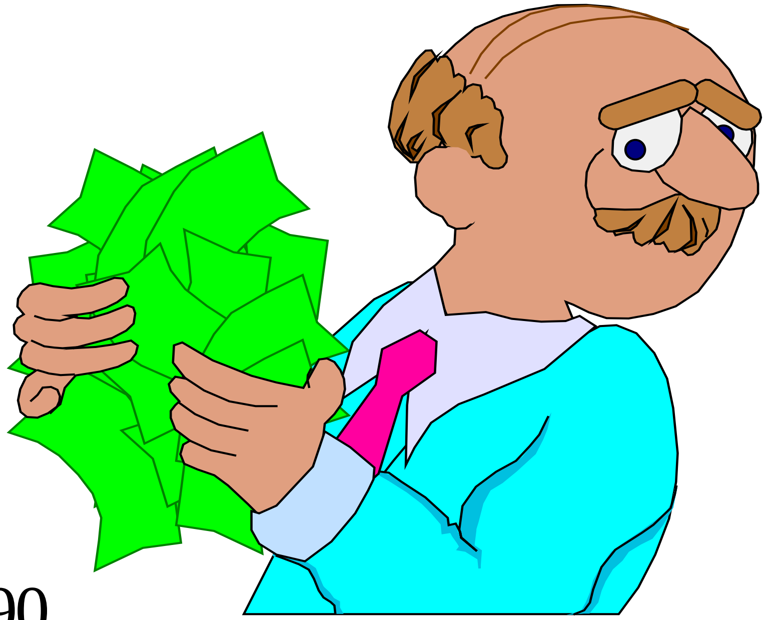
- States receive $1.25 per capita allocation from the IRS
- State allocating agencies issue an allocation plan
- Sponsors/Developers apply for LIHTCs
- Applications rated by the allocating agency on a point system

How do we apply for LIHTCs?

- Federal law sets aside a <u>minimum</u> of 10% of credits for not-for profit project sponsors
- State's determine how credits are awarded
- Know your State's priorities
  - Competitive points are awarded to sponsors serving the lowest income and in some states, special needs groups
  - Competitive points are awarded to projects that have other funding in place and are ready to go under construction

Who will buy our credits?

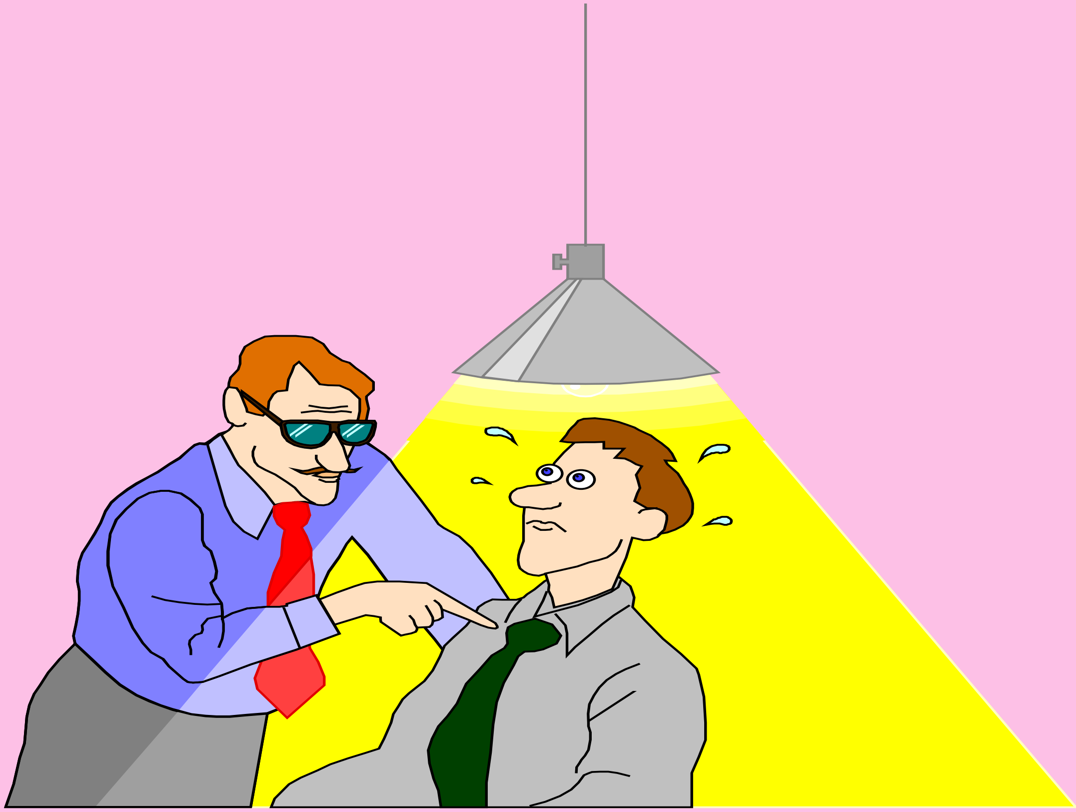
- **EASY ANSWER:**
  - **NEF!**
- **Equity contribution**



Annual Credit Amt.	$329,829
Credits over 10 Years	$3,298,290
Equity price per credit	$.75
Total Project Equity	$2,448,980

Tax Credits Are Your Friends

- can provide between 30% and 60% of your total development costs
- can enable operating and social service reserves
- over 90% of all affordable rental housing is developed using tax credits
- states typically give extra points for special needs, very low income uses and nonprofit involvement



QUESTIONS?

WE KNOW YOU HAVE THEM!