

Financing Developments with Tax Credits



MHEG
Midwest Housing Equity Group



Presenter Background



- Sammy Ehtisham, Assistant Vice President of Acquisitions
- Work exclusively with developments that utilize the Federal Low Income Housing Tax Credit. Also have Historic Tax Credits and State Low Income Housing Tax Credits on some deals.
- 1,500+ units of affordable housing in 50 developments across Oklahoma and Arkansas over the past 9 years representing \$220 million in development costs.

Midwest Housing Equity Group, Inc.



In 1992, Senator Ben Nelson, governor at the time, appointed a group of people to a Nebraska Affordable Housing Commission to lay the groundwork in creating a state equity fund. The objective was to raise equity capital to invest into affordable rental housing throughout Nebraska through use of the federal low income housing tax credit program as defined in Section 42 of the Internal Revenue Code. As a result, Midwest Housing Equity Group, Inc. (formerly known as the Equity Fund of Nebraska) was created as a non-profit tax credit syndicator.

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Midwest Housing Equity Group, Inc.



Fast forward 23 years and MHEG now currently operates in 10 states and has offices in:

- Omaha, NE
- Oklahoma City, OK
- Topeka, KS
- Des Moines, IA



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MHEG Impact



- 442 Projects to date
- Over \$1.2 billion in private equity invested
- Over 13,100 affordable units created



Today's Discussion



- The Low Income Housing Tax Credit Program
 - What is the LIHTC program?
 - Who governs the LIHTC program?
 - How do you get LIHTC's?
- Key players in these developments
- What can you do with the LIHTC and how do they benefit developments?
- Syndicator roles and purpose of involvement

(continued)

Today's Discussion (cont.)



- Combining LIHTCs with Other Tax Credits
 - Federal Historic Tax Credits
 - State Historic Tax Credits
 - State Low Income Housing tax Credits.

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What is the LIHTC Program?

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What is the LIHTC Program?



- The Federal Low Income Housing Tax Credit program was created under the Tax Reform Act of 1986, as amended.
- This program creates affordable rental housing through a partnership of public and private partners.
- The program is responsible for the creation of nearly 3 million units of affordable housing since inception.
- Widely regarded as the most successful affordable housing program in history.

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What is the LIHTC Program?



- What is a tax credit?
 - Dollar for dollar reduction in your tax liability
 - Not the same as a deduction.
- LIHTC
 - Credit to the owner annually over a 10 year period (Credit Period)
 - Requires a 15 year compliance period.

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Who Governs the LIHTC Program?



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Who Governs the LIHTC Program?

- Being a Federal Tax program, the LIHTC program is governed by the Internal Revenue Service.
 - Specifically Section 42 of the Internal Revenue Code.
- Each state also plays a significant role in the LIHTC program.
 - Required to develop Qualified Allocation Plans (QAP) that detail the process by which applicants can apply for these credits.
 - Required to perform long term Compliance and report non-compliance to the IRS.

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Qualified Allocation Plan (QAP)



- IRS establishes “minimum compliance” requirements and relies on each state to develop their QAP
- States can choose to be more restrictive than Section 42 requirements, but not less restrictive.
 - Allows each state to align the program with its respective housing goals.
- QAP will establish the threshold and selection criteria items that will be considered when applicants apply for LIHTCs in each state.
- QAP establishes application deadlines.

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Qualified Allocation Plan (QAP) (cont.)



- Each state determines their acceptable minimum underwriting standards through the QAP.
- The QAP will specifically limit the amount of developer fee and contractor fees that can be earned.
 - Some states even limit architecture fees and consultant fees.
- Will establish maximum LIHTC allocation amounts per development.
- Will also set maximum cost per unit limitations.

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Qualified Allocation Plan (QAP) (cont.)



- We have all learned about the Statewide Housing Study that was just released.
- We need to do our part to work with OHFA to adjust their 2017 QAP to best address the needs as shown in this housing study.
- That means participating in input sessions as OHFA has them available.

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How do you get LIHTC's?

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How do you get LIHTC's?



- Each state administers the LIHTC program through their Housing Finance Agency (OHFA, ADFA, TDHCA, NIFA, KHRC, etc.)
- Each state receives an annual credit ceiling of LIHTCs to allocate
 - For 2015 it is the greater of \$2.30 per person in each state or \$2,680,000.
 - Annual credit authority applies only to 9% developments. 4% developments financed with Tax Exempt Bonds have a theoretically endless availability.
- Applications received are awarded via a competitive scoring process

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How do you get LIHTC's? (cont.)



- Very competitive process
- Can cost anywhere from \$10,000 to \$60,000 or more to put an application in for consideration.

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Key players in these developments

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Key Players



- Federal Government
 - Credits allocated to each state, IRS oversees Compliance
- State Housing Finance Agencies
 - Perform their own underwriting analysis of each project
 - Credits are allocated to developers per HFA's QAP
- Developer/General Partner
 - Masterminds behind the concept for the projects
 - Manage day to day operations and provide guarantees
- Lenders
 - Performs their own underwriting analysis of each project
 - Provide construction and/or permanent financing.

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Key Players (cont.)



- Syndicator/Limited Partner
 - Equity Provider
 - Performs their own underwriting analysis of each project
 - Long-term partner
 - Monitor compliance, financials, physical condition for 15 years
- Property Management Company
 - Day to day site management
 - Lease project to qualified residents in accordance with Section 42
- Attorneys/Accountants
 - Accountants certify costs (10% test, cost cert) and perform annual audit & tax returns
 - Issue tax opinions

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What can you do with the LIHTC?

How do they benefit developments?

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What can you do with LIHTC?



- Types of Projects
 - New Construction
 - Acquisition Rehab
 - Acquisition Rehab on Historic Buildings
- Can combine with commercial space
- Can include some market rate units.



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What can you do with LIHTC? (cont.)



- Types of buildings
 - Apartments
 - Duplexes
 - Single Family Homes
 - Assisted Living
- Rental housing only
 - But can do homeownership in certain instances after year 15.



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How do they benefit developments?



- Provide between 65% and 90% of the total development costs for a project.
- Large equity means lower permanent debt which translates to lower rents for residents.
- Require all residents to earn at or below 60% of the Area Median Income (AMI) for the county the project is located in.
 - Most states give points for targeting lower AMI populations

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Sample LIHTC calculation w/o boost



\$1,000,000	Total Project Cost
<u>\$ 100,000</u>	Project Cost Not Eligible for Credits
\$ 900,000	Eligible Basis for Credits*
x <u>9%</u>	Tax Credit Percentage
\$ 81,000	Credits Received/year
x <u>10</u>	Years credits are received
\$ 810,000	Credits received
x <u>.90</u>	Price paid for credits
<u>\$ 729,000</u>	Equity into project from MHEG

Allows for low debt on project enabling developers to keep rents affordable

** States may allow 130% basis boost (not shown here).*

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Sample LIHTC calculation w/ boost



\$1,000,000	Total Project Cost
<u>\$ 100,000</u>	Project Cost Not Eligible for Credits
\$ 900,000	Eligible Basis for Credits
130%	Basis Boost
<u>\$1,170,000</u>	
x <u>9%</u>	Tax Credit Percentage
\$ 105,300	Credits Received/year
x <u>10</u>	Years credits are received
\$ 1,053,000	Credits received
x <u>.90</u>	Price paid for credits
<u>\$ 947,700</u>	Equity into project from MHEG

Allows for even lower debt on project enabling developers to keep rents affordable

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Syndicator role and purpose of involvement



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Syndicator role and involvement



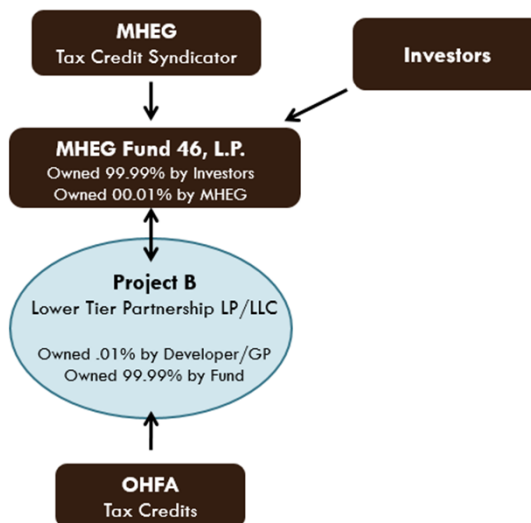
- Role
 - Limited Partner – contribute equity and become a partner
 - Usually require 99.99% ownership in owning entity (whether an Limited Partnership or LLC)
 - Require monthly (some quarterly) reporting to monitor projects
 - Perform regular inspections of units and files
 - Long term partner
 - Thru 15 year compliance period.

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Syndicator role and involvement (cont.)



- Typical Structure



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Syndicator role and involvement (cont.) MHEG Midwest Housing Equity Group

- Purpose of Involvement
 - \$\$\$\$\$\$\$
 - These projects need the cash to reduce the amount of debt needed to construct/rehab the project.
 - Pricing market is constantly moving. Have seen higher demand for these credits in recent years.
 - Provide investors a way to get **SIGNIFICANT** tax benefits.
 - This helps keep the credit pricing strong.
 - Also a good way for banks to get CRA credit.

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Combining LIHTCs with Other Tax Credits.

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Other Credits Available



Here are some of the other credits available that we often see paired with the LIHTC:

- Federal Historic Tax Credits
- State Historic Tax Credits
- State Low Income Housing Tax Credits

- These credits are new to Oklahoma.



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Federal Historic Tax Credits



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Federal Historic Tax Credits



- Federal Historic Tax Credits are available for the rehabilitation of historic, income producing buildings that are determined by the Secretary of the Interior, through the National Park Service, to be “certified historic structures”.
- The State Historic Preservation Office (SHPO) and the National Park Service (NPS) work to ensure that the rehab complies with the Secretary of Interior’s standards for rehabilitation.
 - These rehab standards add SIGNIFICANT costs! Be aware!
- A 20% tax credit is available
 - The IRS defines the qualified rehab expenditures on which the credit may be taken.

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Federal Historic Tax Credits



- Unlike the federal LIHTC, these credits are a one year credit.
- Not unlike the federal LIHTC, pricing for these credits is constantly moving.
 - Although these credits tend to track closer to the federal LIHTC credit price than the other credits we will talk about.
- In order to utilize these credits, one must retain an ownership interest in the property benefiting from the rehab.
 - Typically the federal LIHTC investor buys these HTC’s too.
- Generally doesn’t change the ownership structure of a normal LIHTC deal.

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Federal Historic Tax Credits



- Using Federal Historic Tax credits does impact the underwriting of your LIHTC transaction.
- First you have to determine your historic credit amount. Let's use this:

\$1,200,000	Total Project Cost <i>note higher costs</i>
<u>\$ 200,000</u>	Project Cost Not Eligible for Credits
\$1,000,000	Eligible Historic Basis for Credits
<u>20%</u>	Amount of Credit allowed
\$ 200,000	Amount of Historic Credits

- Now that we have the Historic Credit amount we can finish the LIHTC credit calculation.

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Federal Historic Tax Credits



- So now we go back to the equation we worked through earlier, now with some noted differences:

\$1,200,000	Total Project Cost
<u>\$ 100,000</u>	Project Cost Not Eligible for Credits
\$1,100,000	Eligible Basis for Credits
<u>\$ 200,000</u>	<i>Reduction for Historic Credits</i>
\$ 900,000	Eligible Basis
x 130%	Basis Boost
\$1,170,000	
x 9%	Tax Credit Percentage
\$ 105,300	Credit Received/year
x 10	Years credits are received
\$1,053,000	Credits received

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Federal Historic Tax Credits



- We now have our credit amounts determined and can now figure our equity:

\$ 200,000	Federal Historic Credits
<u>x .90</u>	Price paid for credits
\$ 180,000	Total Historic Equity

\$1,053,000	Federal LIHTCs
<u>x .90</u>	Price paid for credits
\$ 947,700	Total LIHTC Equity

\$1,127,700 Total Equity Received!

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State Historic Tax Credits



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State Historic Tax Credits



- To qualify for Oklahoma State Historic Tax Credits, requirements of both the IRS and the Department of Interior must be met.
- A 20% tax credit is available
 - Mirrors the federal credit
- State Historic Tax Credits are freely transferrable.
 - This means that these credits can be sold to anyone who wants to purchase them – they don't have to go to an owner in the property like with the federal historic tax credits.

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State Historic Tax Credits



- These credits are also a one year credit.
- Some Cautions to Consider:
 - Proceeds generated from the sale of these credits can be considered income and therefore be taxable.
 - Structuring deals with State HTCs can be tricky
 - See the Historic Boardwalk and Route 231 cases
 - As with any of these deals consult legal counsel
 - Pricing on these credits can take some thinking to figure out.

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State Historic Tax Credits



- Pricing:
 - Can range between \$0.40ish to \$0.88ish.
 - Why such a large discrepancy?
- Income!
 - The price paid will depend on who is taking the income hit from the funds generated from the sale.

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State Historic Tax Credits



- These credits have no impact on your eligible basis calculations for the LIHTCs.
- You can run through the calculation for these state historic credits the same way we did on the federal historic credits.

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State Low Income Housing Tax Credits

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State Low Income Housing Tax Credits MHEG Midwest Housing Equity Group

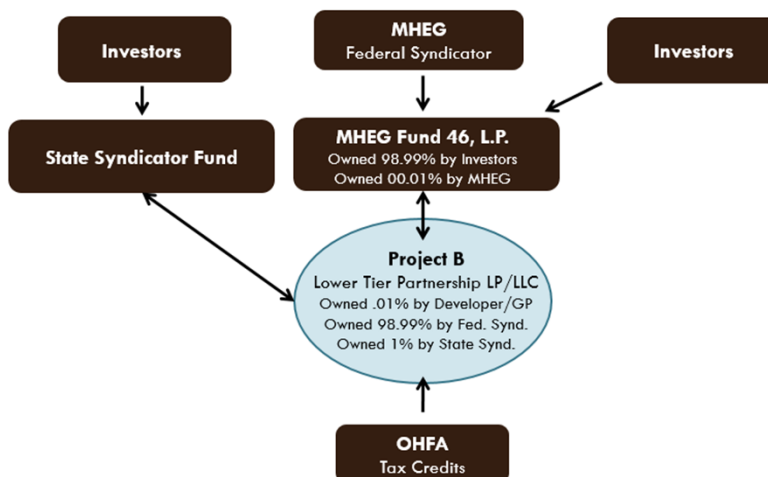
- The Oklahoma Affordable Housing Act of 2014 granted OHFA the authority to allocate Oklahoma State Low Income Housing Tax Credits to Qualified Projects.
- OHFA began making allocations in 2015 – the Act stipulated that no credits could be used before January 1, 2016.
- Total State LIHTCs allocated in any given year cannot exceed \$4,000,000.
- The amount of your State LIHTC request must equal your Federal LIHTC request.
- This credit is exactly like the Federal LIHTC – a 10 year credit period.

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State Low Income Housing Tax Credits



- Can see a change in the ownership structure for deals with State LIHTCs:



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State Low Income Housing Tax Credits



- Pricing for these credits has quickly exceeded initial estimates.
 - Initially State LIHTC syndicators were saying \$.25 to \$.30.
 - Once the program rolled out we've seen prices in the mid \$.40s.
- Requirements for compliance also mirror the Federal LIHTC.
- Currently no separate application is required. If you request Federal LIHTCs you can request State LIHTCs under the same application.

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- Let's look at a few different scenarios to see how the State LIHTC can impact the underwriting of a deal:

Back to our original example of a LIHTC deal:

\$ 1,000,000	Total Project Cost
\$ 100,000	Project Cost Not Eligible for Credits
\$ 900,000	Eligible Basis for Credits
130%	Basis Boost
\$ 1,170,000	
x 9%	Tax Credit Percentage
\$ 105,300	Credits Received/year
x 10	Years credits are received
\$ 1,053,000	Credits received
x .90	Price paid for credits
\$ 947,700	Equity into project from MHEG

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- Now lets see how adding State LIHTCs changes the deal:

\$ 1,000,000	Total Project Cost
\$ 100,000	Project Cost Not Eligible for Credits
\$ 900,000	Eligible Basis for Credits
130%	Basis Boost
\$ 1,170,000	
x 9%	Tax Credit Percentage
\$ 105,300	Qualify for Credits Received/year
\$ 72,900	Only Need this many credits/year
x 10	Years credits are received
\$ 729,000	Credits received
x 1.30	Price paid for credits (assume \$.90 Federal LIHTC and \$.40 State LIHTC)
\$ 947,700	Equity into project from MHEG and State Synd.

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Contact Information



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QUESTIONS?

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