



LIHTC Program

The Joys of 42 IRC



So what's a tax credit?

- It's a dollar-for-dollar reduction in bottom-line federal income tax liability. If a corporation owes \$20 million in annual income tax but has invested in \$10 million of tax credits, they pay only \$10 million on April 15.



The LIHTC Program

- Enacted in 1986 during the Reagan presidency, Title 42 of the IRC induces private-sector investment in qualified low-income rental housing units. Each state can allocate LIHTCs annually equal to \$1.75 per capita. The program now provides over \$4B annually in EQUITY for affordable rental housing production.



What Is Syndication?

- From the Greek for “putting together”, housing developers “syndicate” a deal by forming a Limited Partnership. Typically a CDC is the Managing General Partner; the equity investors are always the Limited Partners. With 99.99% ownership but no management role, the Limited Partners get 99.99% of the Tax Credit benefit.



Ten Year Payback

- Corporation X, a Limited Partner, buys \$10 million of Low Income Housing Tax Credits. They can take that \$10 million credit each year for ten years. So \$10 million of “annual” credits will reduce Corp. X’s tax liability by a total of \$100 million over ten years.



How Much Equity Is Raised?

- Corporation X would pay about \$80 million now for \$100 million reduction in taxes paid over 10 years.
- Equity Raise: described as “80 cents on the dollar” in this case, it is negotiated among the parties and specified in the Partnership Agreement.



Fifteen Years of Compliance

- Even though the tax benefit runs out after ten years, the housing units built using tax credit equity must maintain absolute compliance with LIHTC rules for 15 years or risk “recapture”, punitive repayment to the IRS for tax credits already taken, plus an interest penalty, and loss of any future credits.




The Two Main Rules

■ Income

Households must be low income, based on Median Area Income statistics.

■ Rent

Tenant-paid rent can never exceed 30% of income adjusted for household size, imputed from # of bedrooms in the unit.



20-50 & 40-60 Election

- At a minimum, the owner must promise that EITHER 20% of the units will always be rented to families at or below 50% of Median Area Income OR 40% be rented to families at or below 60%.



More Units, More Credits

- 20-50 and 40-60 are the minimums. To generate maximum tax credits, 100% of the units can be LIHTC-eligible. Most LIHTC projects built since 1986 have an “Applicable Fraction” of 100%, though there is a recent trend toward mixed-income projects.



How are Credits calculated?

- Eligible Basis (most development costs)
- Applicable Fraction (% of low income units)
- Tax credit percentage. This changes monthly for the “9%” and “4%” Credits, tied to Federal Reserve interest rates.



What Costs Are Not “Eligible”?

- Land
- Permanent Financing Fees
- Syndication Costs
- Pre-Funded Reserves



4% and 9% Credits

- “4%” Credit for qualified acquisition, or when other “federally-subsidized” funds are used in project financing, e.g tax-exempt bonds.
- “9%” Credit for new construction or substantial renovations to existing housing units.



The Bump

- Projects located in Qualified Census Tracts (QCTs) or Difficult-to Develop Areas (DDAs) receive a Tax Credit bonus by using 130% of Eligible Basis. This effectively increases the value of the Credits by 30%, and is intended to encourage development in low-income communities.



Example: Debt & Equity

Acquisition

Land	\$50,000
Buildings	\$200,000
Hard Costs	\$650,000
Soft Costs	\$100,000
TDC	\$1,000,000
Mortgage Debt	\$900,000
Equity (Down Payment)	\$100,000
Debt/Equity Ratio	9:1

Adding the 9% Credit

	TOTAL COST	ELIGIBLE BASIS		CREDIT ALLOC.	EQUITY RAISED @ \$0.82
ACQUISITION					
LAND	\$50,000				
BUILDINGS	\$200,000				
HARD COSTS	\$650,000	\$650,000	9%	\$58,500	\$479,700
SOFT COSTS					
ELIGIBLE	\$50,000	\$50,000	9%	\$4,500	\$35,100
NOT ELIGIBLE	\$50,000				
TOTALS	\$1,000,000	\$700,000		\$63,000	\$514,800
DEBT					\$485,200
EQUITY					\$514,800



Both 4% and 9% Credit

	TOTAL COST	ELIGIBLE BASIS		CREDIT ALLOC.	EQUITY RAISED
ACQUISITION					@ \$0.82
LAND	\$50,000				
BUILDINGS	\$200,000	\$200,000	4%	\$8,000	\$65,600
HARD COSTS	\$650,000	\$650,000	9%	\$58,500	\$479,700
SOFT COSTS					
ELIGIBLE	\$50,000	\$50,000	9%	\$4,500	\$36,900
NOT ELIGIBLE	\$50,000				
TOTALS	\$1,000,000	\$900,000		\$71,000	\$582,200
DEBT					\$417,800
EQUITY					\$582,200



Both Credits + the Bump

	TOTAL COST	ELIGIBLE BASIS	TIMES 130%		CREDIT ALLOC.	EQUITY RAISED
ACQUISITION						@ \$0.82
LAND	\$50,000					
BUILDINGS	\$200,000	\$200,000	\$260,000	4%	\$10,400	\$85,280
HARD COSTS	\$650,000	\$650,000	\$845,000	9%	\$76,050	\$623,610
SOFT COSTS						
ELIGIBLE	\$50,000	\$50,000	\$65,000	9%	\$5,850	\$47,970
NOT ELIGIBLE	\$50,000					
TOTALS	\$1,000,000	\$900,000	\$1,170,000		\$92,300	\$756,860
DEBT						\$243,140
EQUITY						\$756,860



Debt/Equity Ratios

Note that starting from a D/E ratio of 9:1 and adding tax credits, the D/E goes to .94:1, then to .72:1, and finally to .32:1!

Less debt means less debt service, which allows more affordable rents. That's why we love our tax credits....



How Are Credits Allocated?

- Each state has a Housing Finance Agency that allocates their annual share of Credits according to their Qualified Allocation Plan.
- Each state updates their QAP annually, and must consider public comments in the process.