BEACON
DEVELOPMENT
GROUP

Development Use of Low Income Housing Tax Credits

Paul Purcell
President, Beacon Development

What is the Low-Income Housing Tax Credit?

- Began with Tax Reform Act of 1986; tax credits are now the primary vehicle for low-income housing construction and rehabilitation in the U.S.
- Federal tax incentive to encourage the production of low-income housing (Section 42 of the Internal Revenue Code)
- Dollar for dollar reduction in federal tax liability for ten years, must be held or bonded for 15 yrs.
- Through partnerships, investors receive tax credits in return for equity investments

how do tax credits work?

Who are the players

- With a non-profit sponsor:
  - Sponsor is General Partner/MM
  - Investor is limited partner/IM
  - Most NP projects have multiple regulatory restrictions based on nature and amount of financing
  - HFC and State regulate fees, debt service coverage, budget

Calculating the Credit

- Amount of Credit is based on the:
  - type of project
  - development costs
  - % qualified low-income units
  - nature and amount of financing

Two Credit Calculations

- Qualified Basis
- Equity Gap

- Credit amount is based on the lesser of these two calculations

Calculating the Credit continued...

- The project's <u>Qualified Basis</u> is:

Eligible Basis X Applicable Fraction

- The Project's <u>Equity Gap</u> is:

Total Project Costs - Sources of Funds (other than the equity from the Credit)

Calculating Credit

Example : Total Project Cost $10,122,994

Basis Calculation		Limit Calculation
eligible basis	$8,400,000	total # of units =49
x applicable fraction	100%	- limit per unit $13,500
Means 100% Of the units are qualified low income		= total ($661,500)
qualified basis	$8,400,000	
	X 8.02%	
credit amount	$688,800	

Credit Amount is $661,500

Credit to Equity

Example : $661,500 in Credit

Owner

(Limited Partnership)

Non-profit sponsor
(General Partner .01%)

Investor(s)
Limited Partner
99.99

TAX CREDITS → **TAX SAVINGS**

$661,500/yr.........over 10 yrs.................equals $6,615,000

HOUSING ← $6,210,810 **EQUITY**

With a .94Tax Credit Factor, $661,500 in credit = $6,210,810 in equity to build project

Development Revenue

LIHTC	$6,210,810
Historic Tax Credit	$1,657,994
City of Spokane	$ 250,000
State of Washington	$1,400,000
FHLB	$ 200,000
Deferred Developer fee	$ 404,190
Private Debt	$

how does the process work?

Project Selection

- IRS requires that preference be given to projects serving the lowest income tenants for the longest period of time
- Projects are ranked based on an objective point system
- Points are awarded in 19 categories which reflect housing and policy priorities statewide
- Commission considers staff recommendations and makes final decision

What are the risks to Sponsor

Sponsor will be required to provide:
-construction completion guarantee
-operating deficit guarantee
-performance compliance guarantee

Implication of financing “Affordable “ Housing Development

- Has to last 40 years
- Funded for capital preservation, not turning in year s 7 to 10
- Funded operating reserves in the dev budget
- 4 to 6 funding sources, due diligence
- Legal fee for structure and transaction
- Not built for cash flow
- Required to carry 15% contingency
- Wage and regulatory requirements of $

Development Budget

Building Acquisition	$1,400,000
Construction	$5,675,711
Sales Tax	$ 484,760
Required contingency	$ 796,356
Architect/Engineering	$ 510,000
Tax Credit Fees	$ 90,000
Loan fees and interest	$ 155,107
Legal/finance consultant	$ 65,000
Reserves	$ 126,000
Development Fee	$ 780,000

Operating Budget

See handout