TAX CREDITS 101

(How to Know Just Enough to Get You In Trouble)

Naomi W. Byrne, Consultant, EJP Consulting Group LLC
JoAnn Rodriguez, Regional Supervisor, Allied-Orion Group

Texas Housing Association

- Resources
  - http://www.txtha.org/index.php/resources/
- Certification Programs
  - http://www.txtha.org/index.php/texas-housing-association-professional-certification-program/
- Upcoming Classes
  - http://www.txtha.org/index.php/calendar/
- Why Texas Housing Association?
- HUD POST
  - http://portal.hud.gov/hudportal/HUD?src=/program_offices/public_indian_housing/post

Agenda

- History
- What is a Tax Credit?
- Why do we need Tax Credits?
  - What can be built, who can live there, how units stay affordable
- Types of Tax Credits
- Developing Tax Credits in Texas
  - Ownership Structure and Parties
  - Development Team
  - Getting Started
  - After Construction
  - Why Me (PHA)?

History

- 1986: Through the Tax Reform Act, Congress enacted Section 42 of the Internal Revenue Code.
  - Section 42 created the Low Income Housing Tax Credit (LIHTC) to provide incentives to the private sector to invest in affordable housing.
  - Credit is a dollar-for-dollar tax reduction.
  - Based on the Rehabilitation or Construction Cost
- 1986 – 1990: LIHTC program authorized on a temporary basis.
- 1993: Congress made the LIHTC program permanent.

History

- <u>2005:</u> In Texas, TDHCA removed the words 'Low Income' from the program name. Now it is called the Housing Tax Credit (HTC) Program.
- <u>2008:</u> Congress enacted the Housing & Economic Recovery Act of 2008 (HERA) – with the most significant changes since 1986.
- <u>2009:</u> Congress enacted American Reinvestment and Recovery Act of 2009 (ARRA) which created the Tax Credit Assistance Program (TCAP) and Tax Credit Exchange (Exchange) on a temporary basis (assistance programs provided as a result of the housing crash).

History

The Tax Credit program is over 30 years old and is the oldest (longest lived) supply side housing program. According to the LIHTC database:

- As of 2015, there are approximately **45,905 projects** – more than **2.97 million** affordable units
- LIHTC program gives the equivalent of **$8B** in annual budget authority
- An average of **1,460** projects and **110,000** units are placed in service ANNUALLY

What Is A Housing Tax Credit?

Housing Tax Credit

- A housing tax credit is a dollar for dollar credit (deduction) on taxes.
  - Ex: I owe $5,000 in federal taxes.

    I buy $1,000 in tax credits.

    I can pay my taxes with:

    $4,000 (cash) + $1,000 (tax credits)
- Program regulated by IRS
- Administered by a State Agency. In Texas, the program is administered by the Texas Department of Housing & Community Affairs (TDHCA)

Why Do We Need Tax Credits?

The HTC program was designed to:

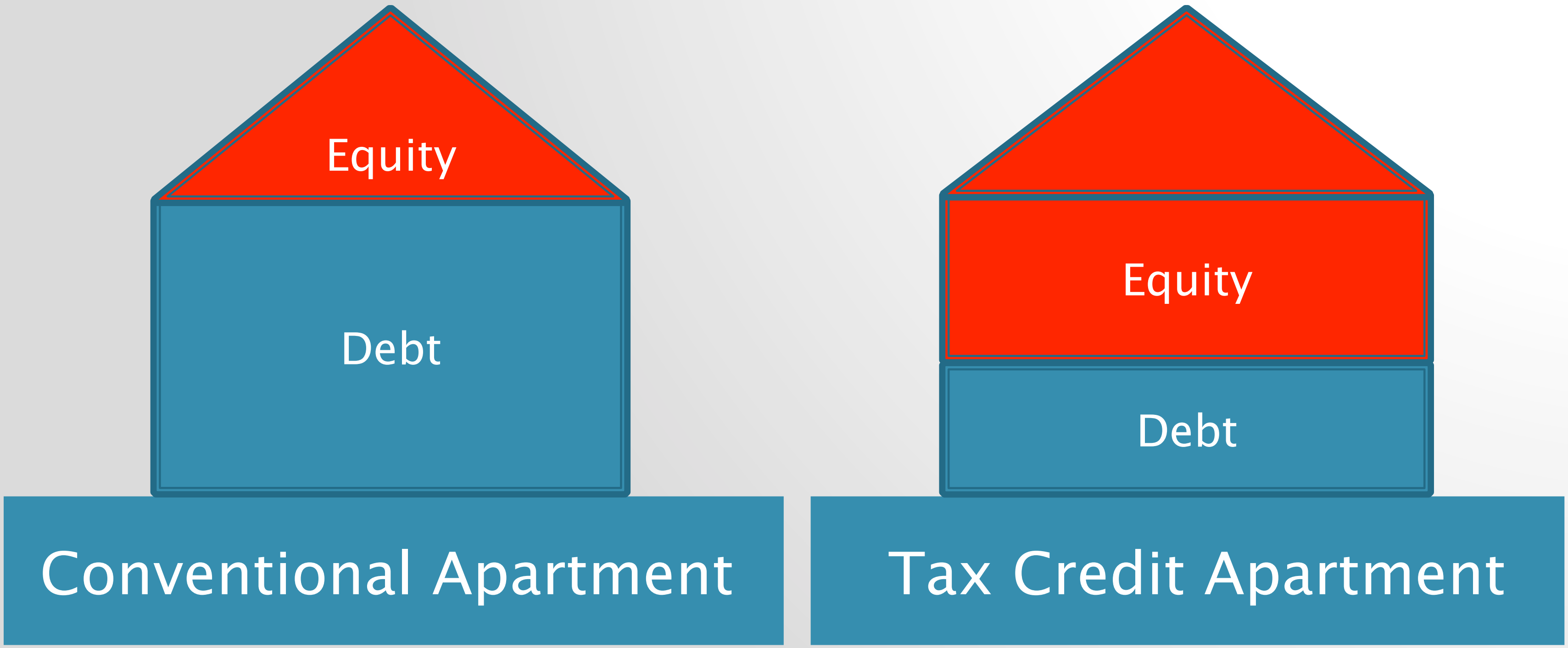
- Provide a source of equity financing for the development of affordable housing;
- Maximize the number of affordable units added to the state's housing supply;
- Ensure that the state's affordable housing supply is well maintained and operated; and
- Prevent losses in the state's supply of affordable housing.

Why Do We Need Tax Credits?

- Tax credits are a Source of Equity:
  - Developers receive tax credits.
  - They sell Housing Tax Credits to investors who use the tax credit to reduce their tax debt.
  - The cash received by the developer is used for development and construction costs.
  - Since this cash is used for some of development/ construction costs, this reduces the loan (mortgage) needed to fill the gap.
  - This result in the ability to charge lower rents since you need less revenue to make your loan payments.

Conventional Apartment
Typically 80% debt/
20% Equity (cash)

Tax Credit Apartment
30% debt (9% HTC)



- The lower the debt, the lower rent has to be to cover the mortgage
  - The owner signs a Land Use Restriction Agreement (LURA) agreeing to keep the rents low for a 30 year period
    - That is what makes it “Affordable Housing”

Why Do We Need Tax Credits?

- More rental units with tenants earning no more than 60% of area median income
- Investors earn dollar-for-dollar credits against their federal tax liability
- Investors also get tax benefits from losses
- HTC can only be used by certain types of companies – large banks (Wells Fargo, Bank of America, Chase, Citibank, etc…), large companies (Google, Verizon), other types of investors

What Can Be Built?

Housing Types – can be multiple types, but must meet the definition of “qualified residential rental property”

- ✓Multifamily Rental, e.g., workforce housing
- ✓Senior Rental (age 55+)
- ✓Single Room Occupancy (SROs) for Homeless

Note: 4% credits can be used for many other things besides housing

Who Can Live There?

- Families w/incomes at or below 60% AMI, or
- Seniors w/incomes at or below 60% AMI w/head of household at least age 55

  Caveat: Must be able to afford the rent

A resident with a voucher from a housing authority can live in Tax Credit Housing and pay 30% of their income for rent.

How Do Units Stay Affordable?

- Each Tax Credit project files a Land Use Restriction Agreement (LURA) with TDHCA and records it in the County records.
- TDHCA, as well as the tax credit investor and the mortgage lender, have regular inspections of the property and review of tenant files.
- Violations may result in loss of tax credits to the investor, and subsequent financial penalties to the developer/general partner. It can also result in debarment of the developer/general partner.

Types of Tax Credit

- 4% Credit
  - Also known as the 30% present value credit
  - Available w/tax exempt bonds through the State's Volume Cap Allocation
  - Non-competitive
- 9% Credit
  - Also known as the 70% present value credit
  - In Texas, these credits are awarded annually on a competitive basis
  - More credits = more cash and less debt

4% Tax Credit

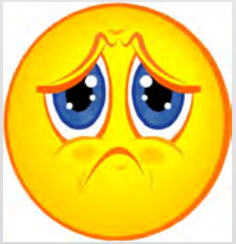
- To be used when 50% or more of costs are financed with tax-exempt private activity bonds.
- States have $100 per capita limit on ALL Private Activity Bonds, also called Volume Cap.
  - ✓Texas receives annual allocation of approximately $2.78 billion
  - ✓Eligible Uses are many – from sewage plants to student loans to affordable housing
  - ✓Approximately $611,000,000 is reserved in Texas for multifamily housing bonds

4% Tax Credit

- When used with Private Activity Bonds, the 4% Credit is a 10 year Credit (Compliance is 30 years).
- Texas Legislature has established development requirements for ‘tiers’ of competition based on affordability factors, and also provided a system for allocating bond cap throughout the 13 Regions.
- Issuers of Bonds can be Housing Finance Agencies, Housing Authorities, Public Facility Corporations, Texas State Affordable Housing Corporation (TSAHC) or TDHCA, but only TDHCA can award the 4% tax credits and application must be filed timely.

4% Tax Credit

- Must have local resolution of NO OPPOSITION, regardless of bond issuer.
- No TDHCA scoring applies to 4% Tax Credits, but must meet Threshold Requirements of the QAP, including notifications, design, amenities, etc.
- Applications are accepted throughout the year.
- 4% HTCs are available statewide; they are not subject to regional allocation.
- NOT AS COMPETITIVE BUT NOT AS LUCRATIVE.



9% Tax Credit

- Designed to subsidize approximately 70% of eligible construction costs.
- Each State receives a per capita allocation of credits from the federal government, adjusted annually. In 2017, the amount is $2.35 per capita. Approximately $65,800,000 was available in 2017 for Texas.
- Credits are figured on a 10 Year period (longer compliance period)
- New construction or substantial rehabilitation (if rehab, building acquisition costs qualify *only* for a 4% credit)

9% Tax Credit

- The 9% HTC program is HIGHLY competitive.
- The amount of tax credits available for 13 regions is determined through the Regional Allocation Formula ("RAF"); there are separate set-asides for "at risk" and US Department of Agriculture ("USDA") assisted developments.
- At least 10% of the allocation must be used for qualified non-profits.
- Applications are scored and ranked within their region or set-aside.

9% Tax Credit

- Scoring criteria range from financial feasibility, various indicators of local support, size and quality of units, amenities and services to be provided to the tenants, economic health of the community, and more.
- Scoring reflects requirements found in state law and program rules; the program rules are known as the Qualified Action Plan ("QAP").
- The QAP changes every year and the program can be complicated.

9% Tax Credit

- Maximum Credit Allocation:
  - $1.5M in credits for single project ($2M for At-Risk) PER YEAR FOR TEN YEARS
  - $1.5M award = $15M in credit
  - $3M annual cap per individual Applicant (max 2 projects per developer per year)
- Limit applies only to 9% developments
- VERY LUCRATIVE BUT VERY COMPETITIVE!!!!!

9% Tax Credit

Year	Pre-Apps	Full Apps	Awards	% of Pre-Apps	% of Apps
2014	302	161	66	43%	22%
2015	325	173	64	37%	20%
2016	382	142	66	46%	17%
2017	380	149	70	47%	18%

MATH TIME

Conventional Construction

- A 50 unit apartment complex costs $10,000,000 to build
- Put $2,000,000 cash into the project (20%)
- Borrow $8,000,000 from bank
  - 30 year note at 7% interest
- Monthly payment (debt service) of $53,224

You'd have to charge $1,064 in rent per household every month just to pay your mortgage!

Tax Credit Construction

- $10,000,000 to build
- Receive $7,000,000 in tax credits (which we sell for $7,000,000)
- Borrow $3,000,000 from bank
  - 30 year note at 7% interest
- Monthly payment (debt service) of $19,959

That's $399 per household every month!

Summary

	MARKET	*TAX CREDIT*
Cost	$10,000,000	$10,000,000
Invest	$2,000,000	$7,000,000
Loan	$8,000,000	$3,000,000
Payment	$53,224	$19,959
Units	50	50
Per unit	$1,064*	$399*
	Savings	$665
	(Per unit/ family)	

* Does not include money to cover property operating costs

Tax Credit Rents

Two Bedroom Rent assumes 3 person family (1.5 persons per bedroom)

- Imputed income at 60% of AMI: $36,000
- Multiplied by:x30%
- Maximum Annual Rent: $10,800
- Divided by (months): ÷12
- Maximum Monthly Rent: $900*
- **must include both rent and utilities –e.g., if the utility allowance on 2BR is $120. Max rent would be $780.*

Who Can Develop Tax Credit Units?

- For Profit Developers
- Nonprofit Developers (10% set-aside for Nonprofits), including Housing Authorities
  - TDHCA has special qualifications to be eligible in Nonprofit set-aside
  - For Profits and Nonprofits can Joint Venture

Tax Credits in Texas

- The QAP outlines the policy objectives and application processes. It has three elements:
  - Set-asides
  - Threshold Requirements
  - Preferences (Scoring)
- Each year, TDHCA posts a draft QAP in early September for public comment.
- TDHCA implements the legislated requirements, both state and federal, as part of its QAP. QAP must be signed by the Governor no later than November 30.

Tax Credits in Texas

- TDHCA accepts applications on an annual basis.
- Credits must be allocated by July 31 of each year.
- Each year's application is different due to changes in the QAP.
- 2 Year QAP was authorized by the Texas Legislature in 2011, but due to varying factors this has not been implemented.

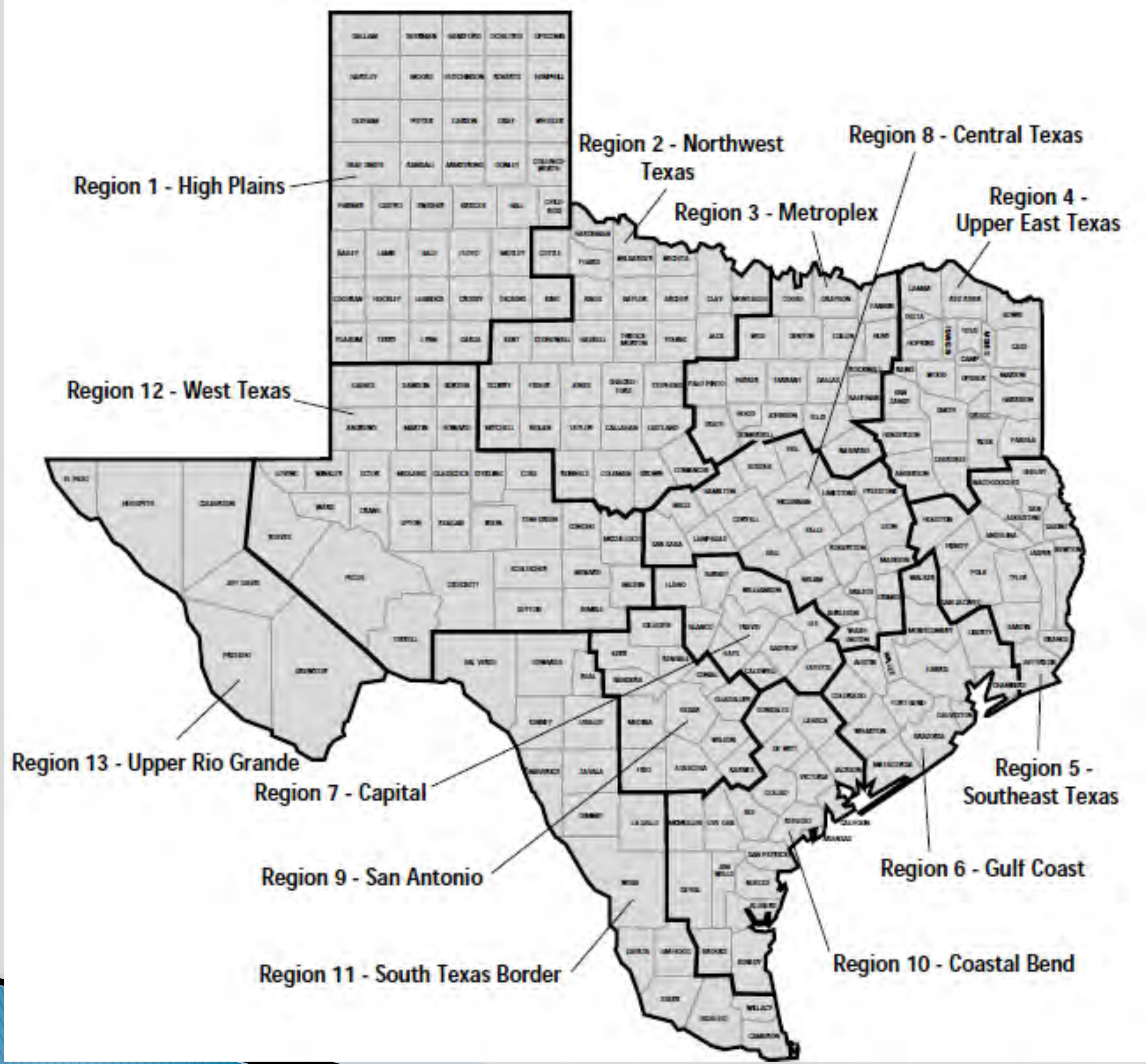
Tax Credits in Texas

- How are 9% Credits Allocated Statewide?
  - TDHCA prepares a formula for distribution, known as the Regional Allocation Formula (or RAF),to the 13 State Regions based on population, housing conditions and participation in other funding programs.
  - Allocation for each Region is split between Urban and Rural, referred to as sub-regions. An Applicant cannot apply for more than 150% of the amount available in the sub-region.

Tax Credits in Texas

- Additionally, there are mandated set-asides:
  - Nonprofit –10% (Statewide) *
  - "At Risk" –15% (Statewide) – of this, 1/3 is allocated for Rural Development (USDA financing)
- In 2014 certain Public Housing Projects were eligible to compete in the "At Risk" category and in 2016, this was expanded to include RAD and HUD Held mortgages, such as Section 202.

*Not a true set-aside, as nonprofits compete in all categories but if 10% don't rise to top, they trump other projects.


Region 1 - High Plains
Region 2 - Northwest Texas
Region 3 - Metroplex
Region 4 - Upper East Texas
Region 5 - Southeast Texas
Region 6 - Gulf Coast
Region 7 - Capital
Region 8 - Central Texas
Region 9 - San Antonio
Region 10 - Coastal Bend
Region 11 - South Texas Border
Region 12 - West Texas
Region 13 - Upper Rio Grande

Development Requirements

- At least 40% of the units must have rents affordable to those at 60% AMI, or
- 20% of the units must have rents affordable to those at 50% AMI
- Affordability is for at least 30 years (some states may require longer). In Texas, extra points are awarded to 9% HTC developments for keeping the housing affordable for 40 years.
- Credits are only awarded on the affordable units. Although Market Rate units are allowed, no tax credits are available for these units.

Development Requirements

- Project Size:
  - Minimum of 16 units
  - No greater than 80 units in a Rural Community
  - No other limitations though the "sweet spot" for 9% credits is ~150 units; 4% credits is ~225
- Developer must meet minimum experience requirement – prior development of at least 150 units
- Architectural Design/Drawings:
  - Must meet minimum energy standards
  - Comply with 504 accessibility guidelines

Development Requirements

- Provide an amenity package (common area and units)
- Minimum unit sq. footages
- Site Control, acceptable to TDHCA
- Must meet minimum site standards
- Site must not contain any negative site features (next to landfill, etc.) or be in an area with undesirable neighborhood characteristics (high poverty, high crime, inferior schools, etc.)

Development Requirements

- Must agree to provide a minimum number of resident services
- Third Party Reports: Market Study, Environmental Study, Appraisals for “identity of interest” transactions and Rehab, Property Condition Assessment (PCA) for Rehab
- Preliminary commitments from lenders and investors
- Notifications to public officials
- No unresolved compliance issues

Scoring

The Texas Legislature has statutorily mandated the following scoring items in descending order:

- ✓ Financial Feasibility
- ✓ Local Government Support
- ✓ Income Level of Tenants
- ✓ Quality of Units
- ✓ Rent Levels
- ✓ Cost of Development per SF
- ✓ Tenant Services
- ✓ Declared Disaster Area
- ✓ Quantifiable Community Participation
- ✓ State Rep Support