



What is a LIHTC?

Tax Credit Basics

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Topics to be Covered

- Background
- Credits vs. deductions
- Why invest in housing tax credits
- Who invests in housing tax credits
- How tax credits flow
- What are the methods of housing tax credit investing
- Turning the credit into money
- What are the pricing considerations
- Additional considerations



Background

- Tax Reform Act of 1986
- Section 42 of IRC of 1986
 - Housing Program in the Tax Code
 - Statute Amended Several Times, Including The Housing and Economic Recovery Act of 2008
- Objective to Provide Investor Equity
- Credit is a Dollar-for-Dollar Tax Reduction
- Program Administered by Each State's Housing Finance Agency
- Eligibility is Based on Tenant Income



Credits Versus Deductions



- \$1 of credit reduces \$1 of taxes owed by \$1
- \$1 of deduction reduces \$1 of taxes owed by the applicable tax rate (i.e. 35%)




Example of Credit Versus Deduction

Taxpayer A

Taxpayer B

	<u>Credit</u>	<u>Deduction</u>
Gross Income	\$1,000,000	\$1,000,000
Less Deduction		(\$100,000)
Adjusted Income	\$1,000,000	\$900,000
Taxes @ 35%	\$350,000	\$315,000
Less Housing Credits	(\$100,000)	
Taxes Owed	\$250,000	\$315,000





Why Invest in Housing Credits

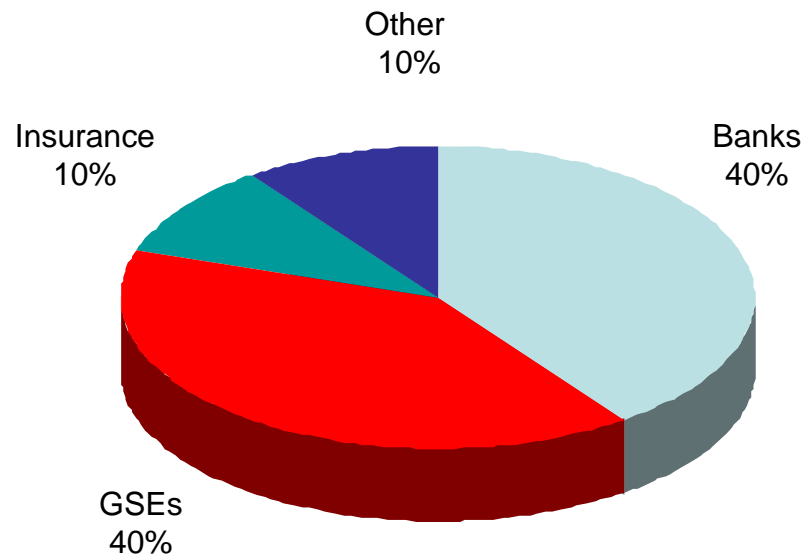


- Increases after tax earnings
- Provides financial return on investment (credits and operating losses)
- Provides financial performance which is similar to bond instruments
- Receives consideration under the Investment Test of the CRA
- Provides safe and affordable housing to residents
- Provides community banks an additional vehicle for their investment strategy

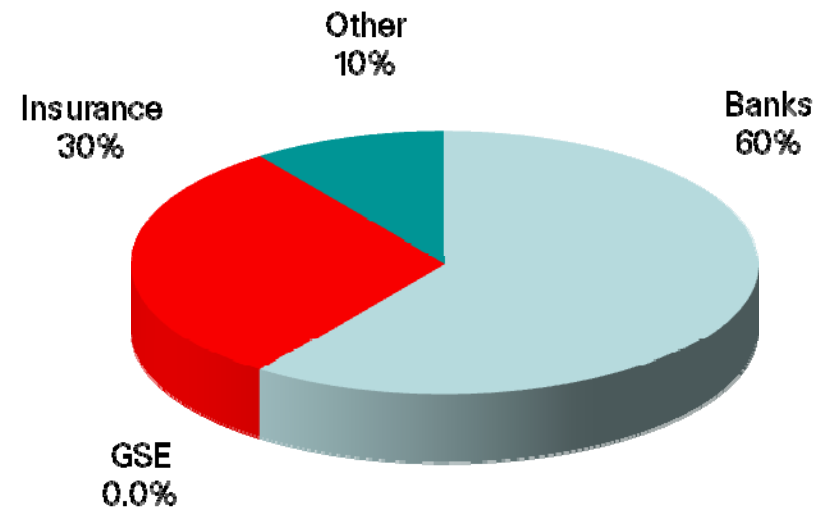


Who Invests in Housing Credits?

2007
(~ \$9 Billion Market)



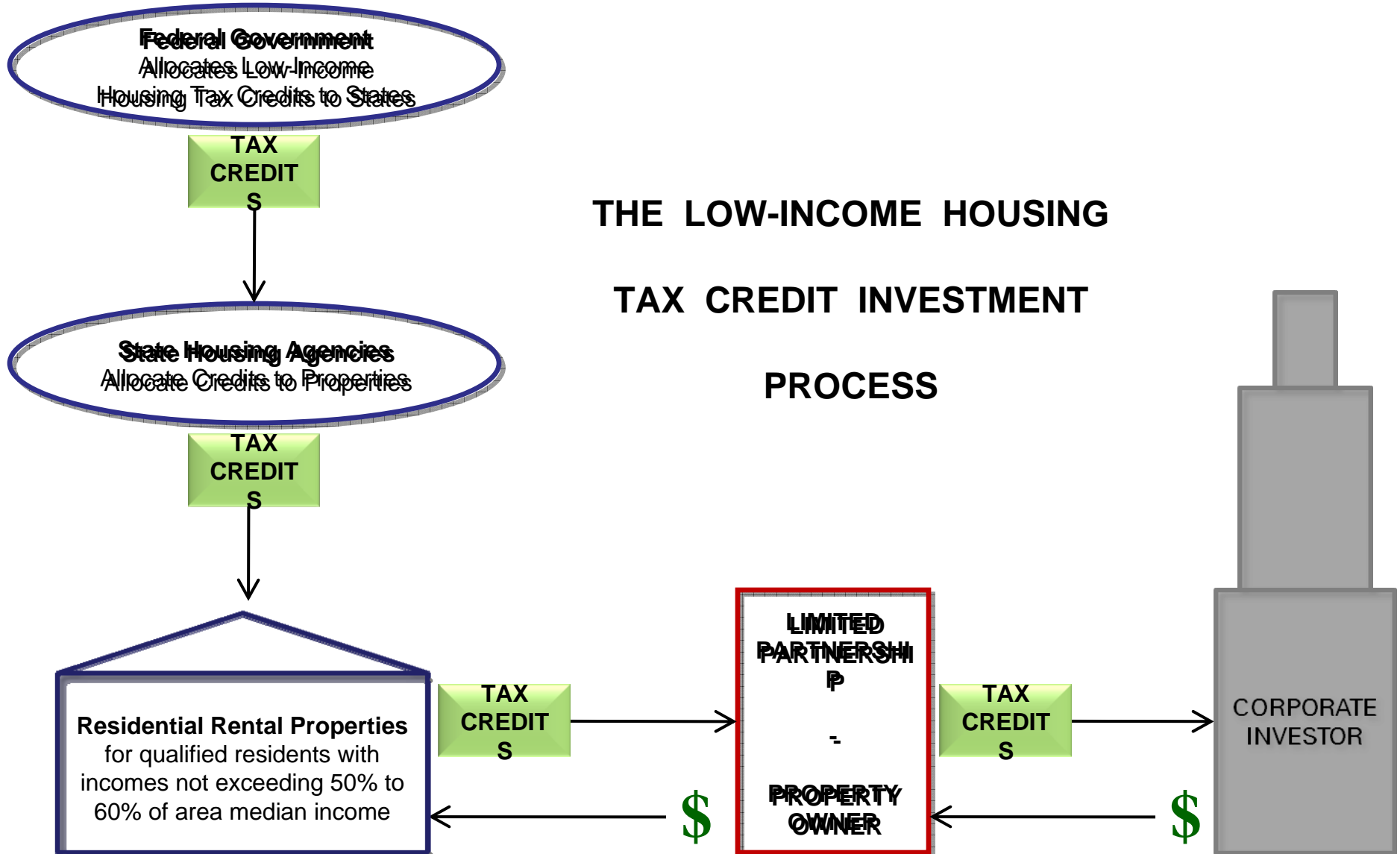
Projected 2008
(~ \$5 Billion Market)





How Tax Credits Flow

THE LOW-INCOME HOUSING TAX CREDIT INVESTMENT PROCESS





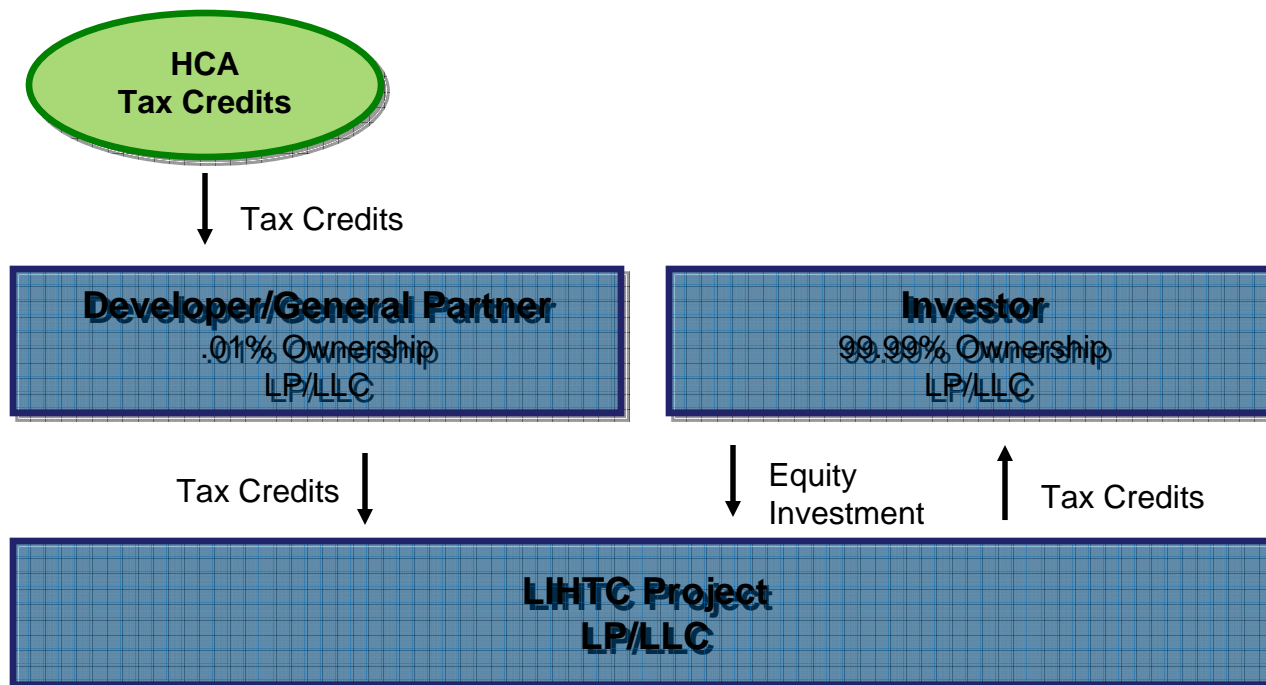
Methods of Investing in Housing Tax Credits



- Direct Investment:
 - Amount of control vs. resource commitment
 - Higher return via higher asset management and underwriting responsibilities

- Fund Investments
 - Size of investment
 - Does fund meet CRA objectives
 - Determine quality of fund performance
 - Lower return via lower asset management and underwriting responsibility

Direct Investment

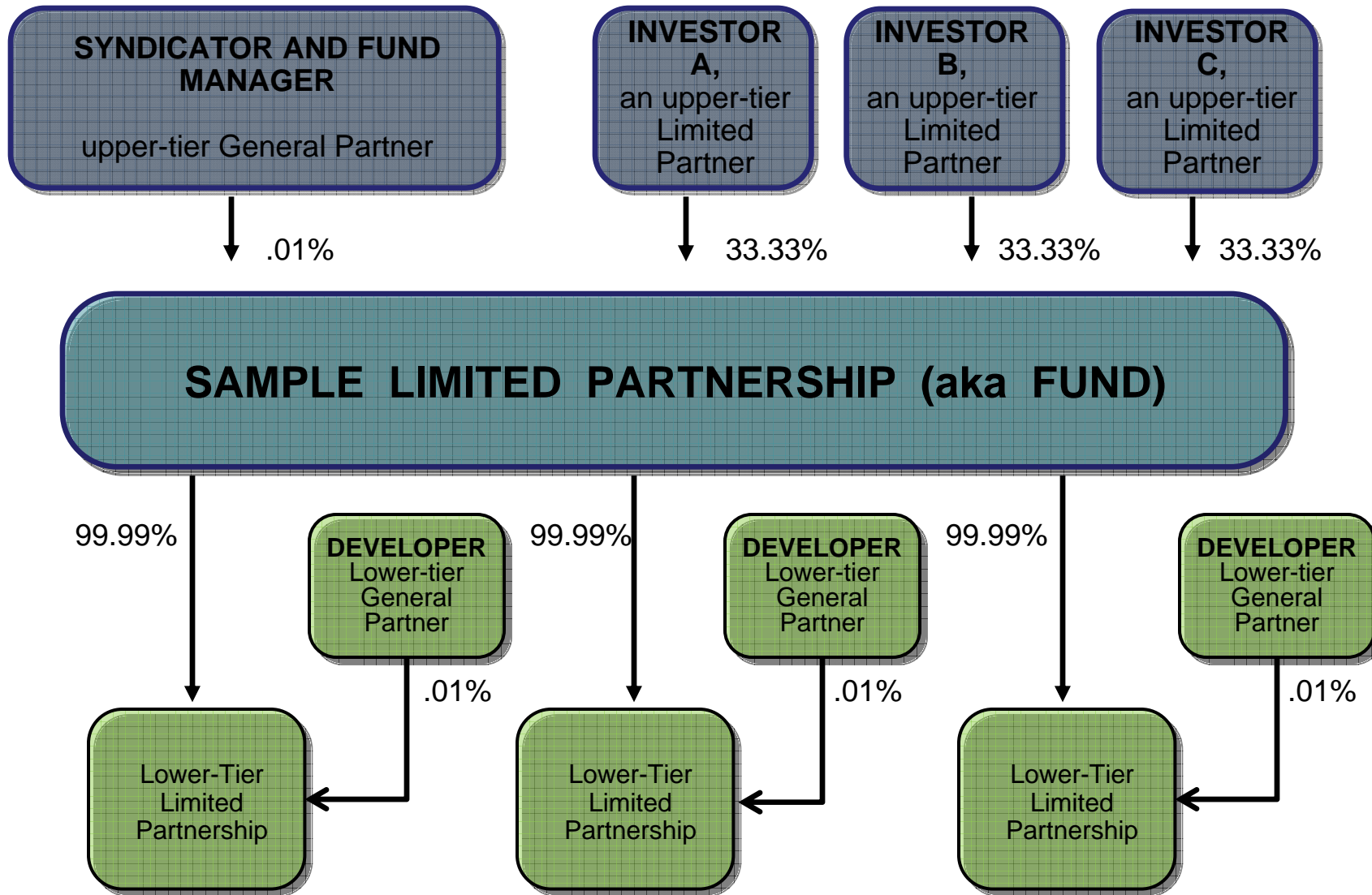


Flow of Tax Credits and Equity Direct Investment

- Developer receives tax credits from the HCA for the LIHTC project.
- Developer establishes a limited partnership (LP) or a limited liability company (LLC) and is 1% owner of the LIHTC Project LP/LLC.
- Investor acquires 99% ownership interest in the LIHTC project, contributes equity to the project, and receives tax credits.



Sample Fund Structure





Turning the Credit into Money



Units	50
Multiplied by Unit Cost (including Land)	\$80,000
<i>Total Cost</i>	\$4,000,000
Land Cost	(\$400,000)
Non-Depreciable Expenses	(\$100,000)
<i>Depreciable Basis</i>	\$3,500,000

Multiplied by Tax Credit Rate	9.00%
Annual Allocation	\$315,000
Multiplied by	10 years
Available Credits	\$3,150,000
Multiplied by Credit Price	\$0.83
Available Equity	\$2, 614,500



Turning the Credit into Money

(continued)



- Pricing Primarily Based on Total Amount of 10 Year Credits Available to Investor and Market Conditions
- Expressed as “Cents Per Tax Credit Dollar”
- In example, if Investor Will Pay 83 Cents Per Tax Credit Dollar, Equity Equals \$2,614,500
- The credit is claimed by the owners of the project in the same percentages as they claim depreciation and other tax losses
- The credit investor will be:
 - a 99.99% or 99.9% limited partner or LLC member
 - a widely held C corporation (not subject to passive activity loss limitations)
 - Subchapter “S” corporate investors (limitations?) ...



Credit Period



- Generally, LIHTC is claimed in equal annual amounts for 10 years
- In the first year, the amount will depend upon when the project is placed in service and what percentage of residential units had tenants in place on the last day of each month
- If the full annual amount is not claimed in the first year, the difference is claimed in year 11



What are a Project's Pricing Considerations



- Timing of the equity investment (pay-in schedule) and the delivery of benefits (credits and tax savings) to the investor
- Desirability of property for CRA purposes
- Strength of development team and guarantors
- Strength of market including net demand from income qualified households and likely achievable rents given income restrictions and asking rents at competing properties
- Alignment of project yield versus fund target



Simplified Investor Benefits Projection



<u>Year</u>	<u>Capital Contributed</u>	<u>Tax Credits Earned</u>	<u>Tax Deductions Earned (at 35% tax rate)</u>
2008	\$200,000	\$0	\$12,000
2009	\$300,000	\$0	\$18,000
2010	\$500,000	\$110,000	\$33,000
2011-2019	\$0	\$110,000 (annually)	\$27,000 (annually, on average)
2020-2024	\$0	\$0	\$22,000 (annually, on average)
Total	\$1,000,000	\$1,100,000	\$350,000

\$1 million investment earns investor \$1.45 million in total benefits and yields a 7% IRR



Additional Considerations



- LIHTC projects have a 15 year compliance period
- In addition, there will be at a minimum a 15 year extended use requirement (Investors typically exit after 15 year compliance period)
- Recapture rules apply in the first 15 years
- General use requirement – “for the use of the general public” governed by HUD & Fair Housing Act