

Presenting a live 90-minute webinar with interactive Q&A

Financing Multi-Family Affordable Housing Projects: Leveraging LIHTCs, HUD loan programs, State Financing and Federal Block Grants

Navigating Strict Requirements for Various Financing Options

THURSDAY, JUNE 12, 2014

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

Roberta L. Rubin, Partner, Klein Hornig, Boston

D. Hara Sherman, Attorney, Goulston & Storrs, New York

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Current Opportunities and Trends in Multi-Family Affordable Housing

Stafford Webinar

June 12, 2014

Roberta L. Rubin

Klein Hornig LLP

617-224-0609

rrubin@kleinhornig.com



Opportunities and Trends

- Shift toward tax-exempt bonds for preservation, allocated LIHTC for new construction
 - May be bundled with HUD Risk Sharing for loans underwritten by an HFA
- Older projects – need for rehab/ recapitalization -
 - Prepayment/transfer & assignment/renewal of existing Section 8
 - Non-profit may realize sales proceeds on sale of HUD-regulated projects
 - Prepaying/recapitalizing projects with 202 loans
 - Opportunities for Section 8 rent increases
 - “Post rehab” Mark Up to Market (MUTM) and Mark Up to Budget (MUTB) rent levels (Chapter 15 of Section 8 Renewal Guide)
 - Other HUD mortgage and rental assistance restructuring
 - Interest rate reductions instead of refinancing
 - LIHTC pilot program (HERA) – streamlined FHA applications (223(f))
 - Recapitalizing LIHPRHA projects, amending LIHPRHA Use Agreements to allow for increased distributions, sales proceeds



Opportunities and Trends (continued)

- Rental Assistance Demonstration (RAD) – conversion of at-risk public and assisted housing to Section 8
 - 1st component – Public housing, mod rehab properties conversion to long-term Section 8 PBRA
 - Competition – 60,000 units
 - 2d component – Rent Supplement, Rental Assistance Payment and Moderate Rehab conversion of tenant-based to project-based assistance on contract expiration/termination
- Choice Neighborhoods/other “mixed finance”
 - “Moving to Work” PHAs - flexibility
- LIHTC, HTC and NMTC/ state credits
 - Condominium structure
 - State LIHTC and HTC



Low-Income Housing Tax Credits and Tax-Exempt Bonds

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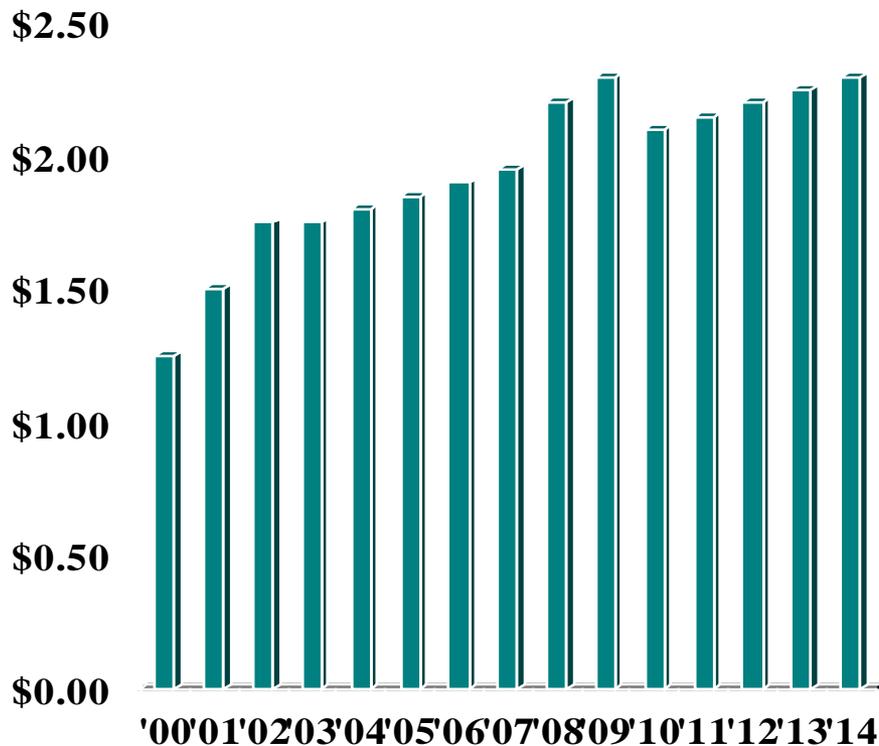
Low Income Housing Tax Credit Basics

LIHTC Background

- Part of 1986 Tax Reform to encourage the construction and rehabilitation of affordable rental housing
- Limited credit allocated to states – based on population, with floor for low population states
- Administered by the Treasury Department and allocated by State Agencies under Qualified Allocation Plans
- Section 42 of the Tax Code (Section 142 governs tax-exempt bonds)
- Credit is a dollar-for-dollar tax reduction
- Credit amount based on cost of constructing or acquiring and rehabilitating housing developments



State LIHTC Allocation Limit



- Credits per state are limited
- In 2000, Congress raised cap from \$1.25 to \$1.50 in 2001, \$1.75 in 2002, and thereafter adjusted for inflation
- In 2008, Congress raised cap from \$2.00 to \$2.20 (2008/2009 only)
- \$2.30 per person for 2014
- \$2,590,000 per-state minimum in 2014



Credit Allocation Rules

- Amount allocated is one year credit amount
 - » Taxpayer receives this amount annually for 10 years
- 10% Nonprofit Set-Aside
- Private Activity Tax-Exempt Bonds subject to bond volume cap; no credit allocation needed, provided 50% test met ($\geq 50\%$ land/building costs paid with bond proceeds)
 - » Bond volume cap also based on population subject to floor
 - » 2014: greater of \$100 multiplied by the state population or \$296,825,000
 - » 2013: greater of \$95 multiplied by the state population or \$291,875,000.



Examples (see IRS Notice 2014-12)

TEXAS

2014 population: 26,448,193

X \$2.30 per capita

\$60,830,844

(based on per capita allocation)

Floor amount: **\$2,635,000**

Allocation is **\$ 60,830,844**

(per capita amount > floor)

NORTH DAKOTA

2014 population: 723,393

X \$2.30 per capita

\$1,663,804

(based on per capita allocation)

Floor amount: **\$2,635,000**

Allocation is **\$2,635,000**

(floor > per capita amount)



Who Can Use Credits?

- C corporations can use credits and losses against ordinary income and taxes
- Passive losses may be disallowed for “closely-held” corporations (≤ 5 individuals hold $\geq 50\%$ of stock value)
 - » Exception (a) if $> 50\%$ of gross receipts are derived from real property trade/business in which materially participates or (b) as a deduction against net active income
- Individuals limited under passive loss rules to approximately \$9,900/year at the 39.6% rate



Why Invest in Low-Income Housing Tax Credit Projects: Tax Benefits

- Predictable 10-year credit stream based on the cost of constructing or rehabilitating residential rental housing
- Depreciation losses
- One year carry back; twenty-year carry forward
- Credits can offset alternative minimum tax for buildings placed in service after 12/31/07, and for rehabilitation expenditures incurred after 12/31/07



Why Invest in Low-Income Housing Tax Credit Projects: Other Benefits

- Potential Economic Benefits:
 - » Cash flow and sale/refinancing sharing (but not generally underwritten)
 - » Asset management fee revenue
- Social Benefits:
 - » Community Reinvestment Act (“CRA”) qualification
 - » Social responsibility/shareholder relations
 - » Some projects may qualify as green investments
- Geographic Flexibility:
 - » Can provide geographic diversification
 - » Can target for local priorities and visibility



Key Business Terms

- Projects owned by limited partnership or limited liability company
- Limited partner generally receives 99.99% of tax credits, depreciation, losses and profits
 - » In some cases, cash flow/proceeds of capital transaction may be divided differently
- Limited partner makes capital contributions in multiple installments (generally 3 to 5), based on negotiated development, financing and performance benchmarks
- General partner guarantees completion/stabilization, amount and timing of credits, and funding of deficits
- Investor protections (removal/repurchase/adjusters)



Example: Ownership Structure

General Partner – 0.01% interest

0.01% share in profits, losses, credits

Controls day-to-day decision-making,
subject to LP veto over major decisions

Share in cash flow, capital proceeds

Limited Partner – 99.99% ownership interest

99.99% share in profits, losses, credits

Does not control day-to-day decision-making

Typically, veto power over major decisions

Share in cash flow, capital proceeds

Limited liability for project debts, liabilities



Credit Overview

- Annual credit for a 10-year credit period
- Basic concept (layman's terms):
(Eligible Basis) x (Low Income Percentage) x (Credit Percentage) x 10 = Total Credits
- Key LIHTC terms:
 - » Applicable percentage
 - » Qualified Basis
 - » Qualified Low-Income Building
 - » Applicable Fraction
 - » Low-Income Units



Credit Overview: LIHTC Terminology

- Credit = “**Applicable Percentage**” x “**Qualified Basis**” of each “**Qualified Low-Income Building**” (IRC §42(a))
 - » “**Qualified Basis**” = “**Applicable Fraction**” x “**Eligible Basis**”
 - › “**Eligible Basis**” includes special LIHTC adjustments
 - › “**Applicable Fraction**” = ratio of “Low-Income Units” to total units (based on unit count or floor area)
 - › Qualified Basis determined building by building
 - » “**Applicable Percentage**” ~4% or ~9% depending on type of activity (acquisition vs. new construction/substantial rehab), whether tax-exempt bond financed



Eligible Basis

Credit = “Qualified Basis” x “Applicable Percentage” of “Qualified Low-Income Building”
“Qualified Basis” = “Applicable Fraction” x “**Eligible Basis**”

- New construction = *adjusted basis* (generally, development cost less land)
- Acquisition = acquisition cost of building
- Substantial rehabilitation = capitalized rehabilitation expenditures (24-month rule)
- Must subtract federal grants
 - » But *not* loans made from proceeds of federal grants
- 130% “boost” in qualified census tracts (“QCTs”) and difficult development areas (“DDAs”)
- Excludes commercial space but includes common areas
 - » Mixed-use projects may require separation of ownership, depending on financing sources



Applicable Fraction; Low-Income Unit;

Qualified Low-Income Building

Credit = “Qualified Basis” x “Applicable Percentage” of “Qualified Low-Income Building”
“Qualified Basis” = “**Applicable Fraction**” x “Eligible Basis”

- “**Applicable Fraction**” = smaller of:
 - » “unit fraction” (ratio of *number* of “**low income units**” to *number* total units)
 - » “floor space fraction (ratio of *floor space* of “low income units” to *floor space* of total units)
- “**Low Income Unit**” = a unit that is both *rent restricted* and *income restricted*
- “**Qualified Low-Income Building**” = a building that is part of a project meeting minimum set-aside test (20/50 or 40/60) throughout the 15 year tax credit compliance period



Minimum Set-Aside Test

Credit = “Qualified Basis” x “Applicable Percentage” of “Qualified Low-Income Building”

- To qualify as a “**Qualified Low-Income Building**,” must meet **Minimum Set-Aside test**.
- Owner may elect either of two tests:
 - » 20% of Units at 50% of Area Median Income (“AMI”), or
 - » 40% of Units at 60% of AMI
 - » Test based on both *income restriction* and *rent restriction*
- Election upon placement in service
 - » In practice, typically made earlier
- Must meet minimum set-aside (based on actual occupancy) by end of first credit year



Income Restrictions

- Either 50% or 60% of AMI, depending on minimum set-aside test selected
- Owner may commit to deeper affordability either in tax credit application or for other funding programs
- HUD publishes area income figures annually
- Income restrictions are based on *actual household income* of household occupying unit
 - » AMI adjusted for household size
 - » Varies widely depending on location even within a state
 - › Boston, MA: 2014 50% AMI for family of 4 = \$47,050
 - › New Bedford, MA: 2014 50% AMI for family of 4 = \$26,850



Rent Restrictions

- Gross rent (Including utility allowance) cannot exceed 30% of qualifying income for *assumed* family size; based on bedrooms per unit, *not* actual family composition
- Rent limits change annually with publication of new area median incomes
- Permitted gross rent will not decrease below original floor (elected at allocation or placement in service)
- Gross rent (i.e., total amount payable by household for rent plus utility allowance) does not include section 8 (or similar rental subsidies)
- Rent payable to owner reduced by allowance for tenant-paid utilities



Applicable Percentage

(Credit = “*Applicable Percentage*” x “*Qualified Basis*” of each “*Qualified Low-Income Building*”)

- Two Credit Rates:
 - » “4% Credit” = 3.25% for June 2014 (Floating)
 - » “9% Credit” = 7.58% for June 2014 (Floating)
 - » “Not Less Than 9.00%” for Buildings Placed in Service After 7/30/08 and Before 12/31/13 (or with binding commitment prior to 12/31/13 of 2014 credits)
 - » Calculation for floating credit rates: % which will yield over 10-year period total credit with present value = 30% or 70%, as applicable, of qualified basis
- Owner elects to set applicable percentage either (i) when receiving a binding commitment from the state (or when tax-exempt bonds are issued), or (ii) when building is placed in service



Applicable Percentage: Tied to Financing and Construction Methods

Construction Method

Financing Method

	New Construction	Acquisition/ Rehabilitation
Non-Federally Subsidized (Competitive Credits)	"9%" credits	Acq – "4%" Rehab – "9%"
Federally Subsidized (Tax Exempt bonds)	"4%" credits	Acq – "4%" Rehab – "4%"



Applicable Percentage: When “4%” vs. “9%” Credit Rate Will Apply

- Qualifying for the “4% Credit”
 - » Acquisition of building
 - » New construction/substantial rehab if project financed with tax-exempt bond financing
- Qualifying for the “9% Credit”
 - » New construction/rehabilitation if not “federally subsidized” (which now means financed by tax-exempt bonds)
 - » New rule: “below market federal loans” no longer disqualify building from 9% credit



4% Credit for Acquisition

- Based on the acquisition cost of an existing building
- Purchase from an unrelated party
 - 50% related party rule
- Ten-year rule
 - Not placed in service within 10 years prior to purchase
- Certain placements in service ignored
 - » Acquired from decedent
 - » Placement in service by governmental unit or nonprofit entity
 - » Acquired through foreclosure by insured depository institutions
 - » Property in dilapidated condition not available for use
 - » Buildings assisted, financed or operated under HUD- or Rural Housing-administered programs or similar State law.



Substantial Rehabilitation Requirement

- To be eligible for acquisition credit, must fulfill substantial rehabilitation requirement
- Expenditures during a 24-month period selected by the taxpayer must equal the greater of:
 - » \$6,000 per low-income unit (as adjusted for inflation – in 2014, \$6,300), or
 - » 20% of adjusted basis
- Rehab expenditures treated as separate new building
- 4% (tax-exempt bond financed costs, acquisition costs) or 9% credit on expenditures
 - » Will have different credit rates for acquisition and rehabilitation if not tax-exempt bond financed



“9% Credit” for New Construction or Substantial Rehabilitation

- For Buildings Placed in Service After 7/30/08:
 - » Tax-exempt bond-financed → ineligible
 - » Federal *grants* must be excluded from eligible basis to qualify for “9% credit”
 - › But *loans* of Federal grant proceeds may be included in eligible basis
- Properties receiving 9% credits with below-market HOME loans now eligible for 130% boost if located in a QCT/DDA
 - » Prior to statutory amendments, were ineligible for basis boost



Credit Period

- Credit is an annual credit for a 10-year credit period
 - » May extend into 11th year if partial first credit year
- Credit period begins when a building is placed in service unless the taxpayer elects to defer the start of the credit period to the next taxable year
- First year credit reduced to reflect qualified occupancy during first credit year



Example of Tax Credit Calculation (New Construction, No Tax-Exempt Bonds)

- 100 Unit Project/70 Low-Income Units
- Total Development Costs (Including Land) = \$10,000,000
- Land Cost = \$1,000,000
- Eligible Basis = \$9,000,000
- Qualified Basis = \$6,300,000 ($\$9,000,000 \times 70\%$)
- Applicable Percentage = 7.58% (“9% credit)
- Annual Credit = \$477,540 ($\$6,300,000 \times 7.58\%$)
- 10-Year Credits = \$4,775,400



Example of Tax Credit Calculation (Acquisition/ Substantial Rehabilitation, No Tax-Exempt Bonds)

- 100 Unit Project/70 Low-Income Units
- Total Development Costs (Including Land) = \$10,000,000
 - » Land Cost = \$1,000,000
 - » Building Acquisition Cost = \$4,000,000
 - » Other Development Costs = \$5,000,000 (assume gut rehab)
- Eligible Basis = \$9,000,000; Qualified Basis = \$6,300,000
- Applicable Percentage = 7.58% for rehab, 3.25% for acq.
- Annual Credit = [\$91,000 ($\$4,000,000 \times 70\% \times 3.25\%$) + \$265,300 ($\$5,000,000 \times 70\% \times 7.58\%$)] = \$356,300
- 10-Year Credits = \$3,563,000



Example of Tax Credit Calculation (Acq/Rehab Or New Construction, Tax-Exempt Bonds)

- 100 Unit Project/70 Low-Income Units
- Total Development Costs (Including Land) = \$10,000,000
 - » Land Cost = \$1,000,000
 - » Building Construction or Acquisition/Rehabilitation Cost = \$9,000,000
- Eligible Basis = \$9,000,000; Qualified Basis = \$6,300,000
- Applicable Percentage = 3.25% (tax-exempt bonds)
- Annual Credit = $\$6,300,000 \times 3.25\% = \$204,750$
- 10-Year Credits = \$2,047,500



Equity Calculation

- Pricing typically based on total credits available to investor (and timing of delivery) and market conditions
- Expressed as “cents per tax credit dollar”
- In first example above, if investor will invest \$0.85 per tax credit dollar, equity = \$4,058,684
 - » \$4,775,700 total credits X 99.99% x 0.85
- Equity generally paid in several installments (often 3 to 5 installments) based upon negotiated benchmarks
- If bond-financed 4% deal, equity = \$1,740,201
 - » \$2,047,500 total credits x 99.99% x 0.85



Affordability Commitment

- 30-Year Minimum Affordability Commitment
 - » 15-Year Tax Credit Compliance Period
 - » 15-Year Extended Use Period
- Extended Use Agreement
- Early Termination of 30-year Affordability Commitment
 - » Foreclosure (or Instrument in Lieu of Foreclosure)
 - » Qualified Contract Process
- Owner may commit to longer affordability to gain points under QAP



Recapture

- Recapture on Non-Compliance:
 - » Accelerated portion of credit recaptured (1/3 of credit first 10 years, decreasing through year 15)
 - » If minimum set-aside fails, all accelerated credits recaptured
 - » Otherwise, unit-by-unit (extent of decrease in qualified basis due to unit failing to meet income and rent restrictions)
- Full Recapture on Transfer of Project or Interest Therein
 - » De minimis (1/3 ownership) exception



Tax-Exempt Bond Basics

What are Tax-Exempt Bonds?

- Section 103 of the Internal Revenue Code
 - » Interest income is exempt from Federal tax
 - » Interest income is generally exempt from state tax
- What Kinds of Bonds are Eligible?
 - » Private Activity Bonds – finance projects of for-profits
 - › Only private activity bonds work with housing credits – Section 142 of the Code
- Governmental Bonds and §501(c)(3) Tax-Exempt Bonds generate tax-exempt interest, but they don't work with housing credits



Basics of Housing Bonds

- Housing bonds are revenue bonds
- Issuer is not lending its own money
- Issuer has no liability for debt service on the bonds
- Issuer is a “conduit” – acts as pass-through agent
- Note that these bonds must be sold – just because the state will issue bonds doesn’t mean that there is a buyer who will put up the money



Why are Developers Doing Tax-Exempt Bond Deals?

- High demand for 9% tax credit allocations, which are awarded competitively
- Limited “pool” of tax credits. Traditionally, states are oversubscribed for credits (4 or 6 to 1).



What are the Benefits of Bonds?

- Reduced Interest Rate (More Debt!)
- Possible To Reduce Debt Coverage Ratios
- “Automatic” 4% Tax Credit Allocation
- Fewer Operational Regulations Than LIHTC, but LIHTC rules will often apply anyway



Some Bond Observations

- Not like credit competition, but there is still competition and developers must overcome hurdles to get bond approval
- Credit Enhancements may be available (sometimes expensive, not always used, add complexity)
- Bonds have lower interest rates than conventional debt (but currently both are low)



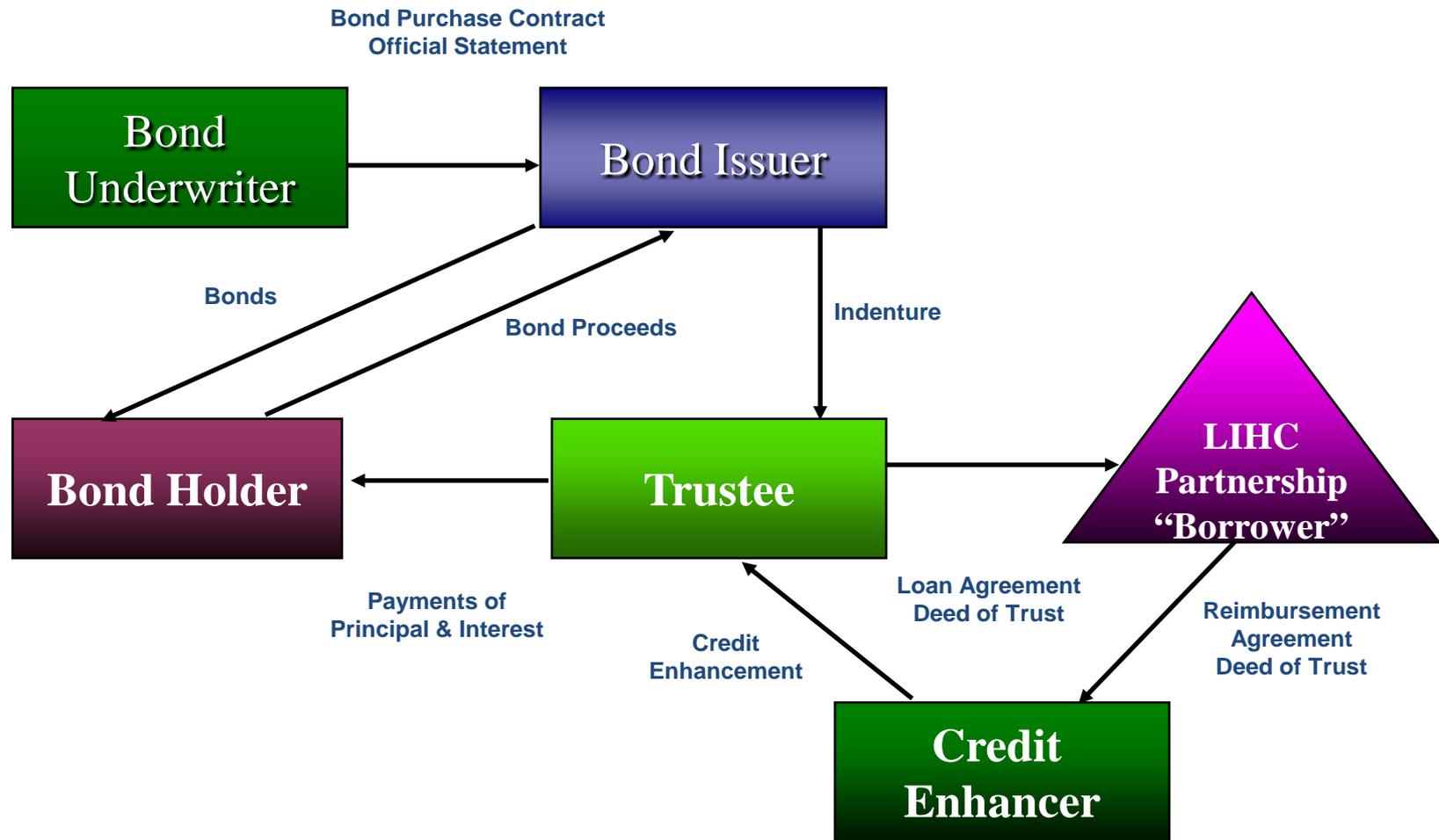
More Bond Observations

- Volume cap applies to all private activity bonds
 - » Housing competes with other uses
 - » Typically, housing bonds are about 55-60% of the total, but this varies by state and demand
 - » Some states dedicate bonds to particular uses
- Must pass 95/5 test and 50% test, described later
- Also need “42(m) letters” that project complies with the QAP and does “not exceed the amount... necessary” for “financial feasibility”
 - If housing agency and bond issuer are separate agencies, may need two separate letters.



Structuring Bond Transactions

What does a typical Tax-Exempt Bond Structure Look Like?



Sample Bond Deal Steps

(will vary by project, state)

1. Find a potential property and run initial numbers for feasibility of the project
2. Put the team together:
 - a. Tax Professionals
 - b. Equity Partner
 - c. Bond Underwriter (if applicable)
 - d. Bond Counsel (may be engaged by Issuer)
 - e. Credit Enhancer (if applicable)
3. Private activity bond application submitted to Issuing Authority



Bond Deal Steps

4. Issuer passes inducement resolution
5. Credit enhancement commitment (if applicable)
6. Public notice of the project (2 weeks)
7. TEFRA hearing held
 - » The Tax Equity and Fiscal Responsibility Act
8. Private activity bond application approved
 - » Bond allocation awarded
9. Tax credit application submitted to state agency (need “42(m) letter(s)”)



Bond Deal Steps

10. Bond counsel drafts closing documents
11. Issuer passes bond resolution including:
 - » Issuer's approval of TEFRA hearing
 - » Private activity bond allocation
 - » Credit enhancement commitment
 - » Bond rating from agency
 - » Preliminary official statement
12. Underwriter prices and contracts for bond sale
13. Bond purchase agreement
14. Bond Closing
15. Final Official Statement (if applicable)



Special Rules:

Good Costs vs. Bad Costs

- At Least 95% of bond proceeds must be used to pay or reimburse “Good Costs”
- “Good Costs” Include:
 - » Land & Depreciable costs
 - » Paid or incurred not more than 60 days before the date of Inducement Resolution
 - » “Good Costs” also include bond interest prior to placement in service



Special Rules:

Good Costs vs. Bad Costs

- “Bad Costs” include:
 - » Costs incurred prior to inducement resolution
 - » Intangible assets
 - » Bonds issuance costs and underwriting
 - » Loan origination fees amortized over the permanent loan period (they aren’t “construction”)
 - » Most bond counsel require development fees to be paid from other funds



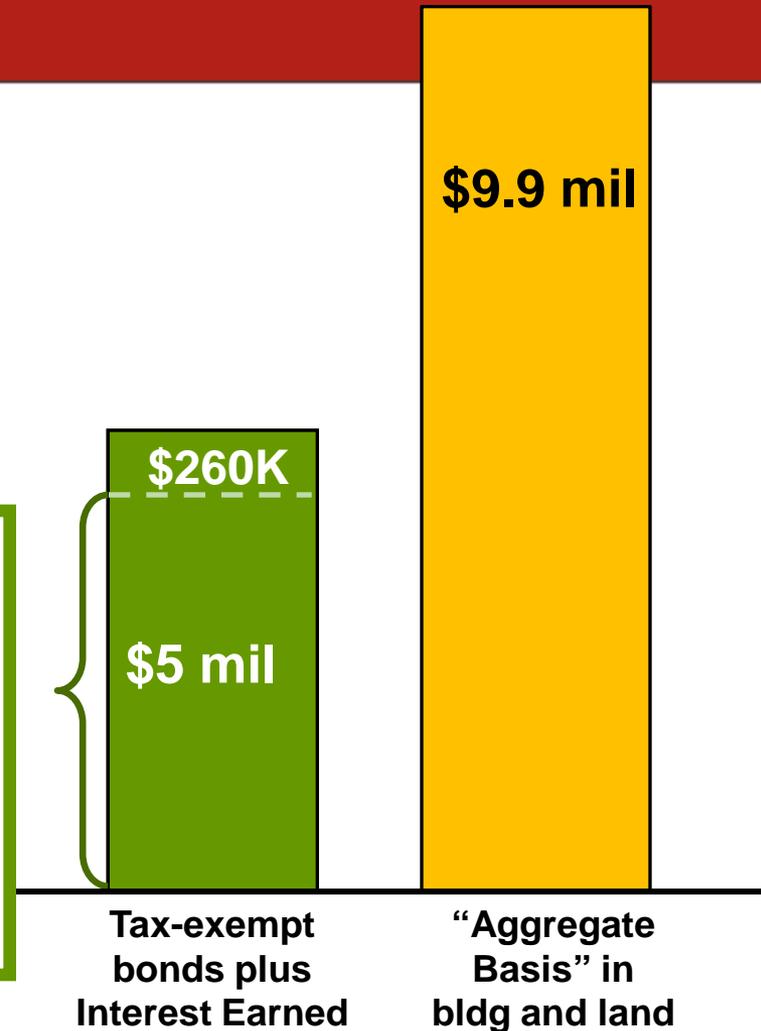
“Good Costs/Bad Costs”

95% of bond proceeds must be used for “good costs”

Good Costs

Land and depreciable costs for income tax purposes paid or incurred not more than 60 days before the date of the Inducement Resolution

$$5 / 5.26 = 95.05\%$$

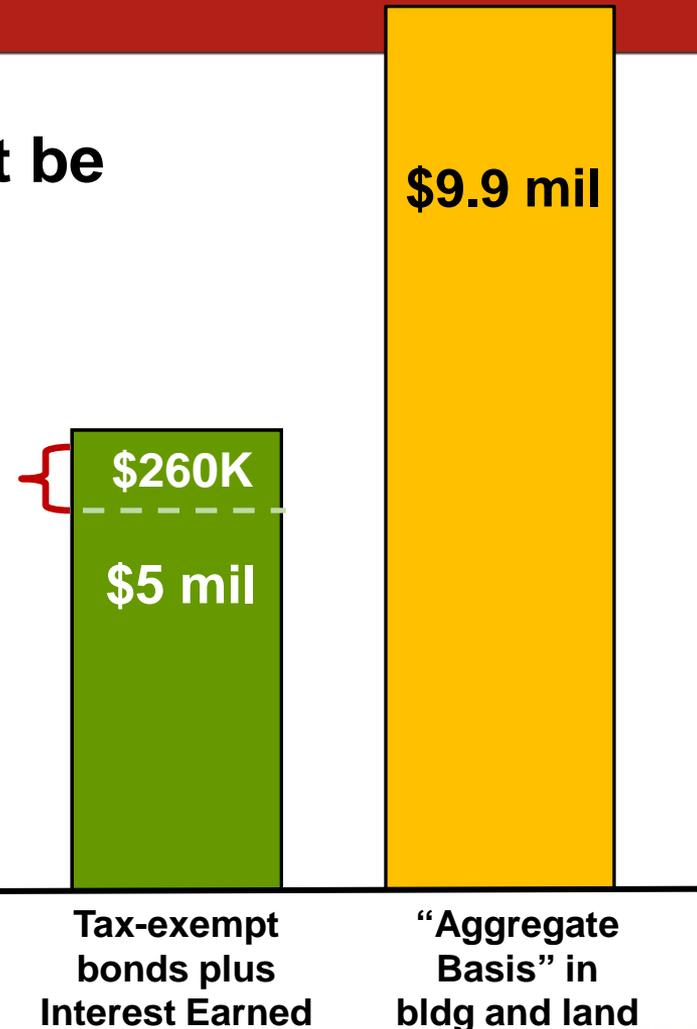


“Good Costs/Bad Costs”

95% of bond proceeds must be used for “good costs”

Bad Costs

- Costs incurred more than 60 days prior to Inducement Resolution
- Intangible assets
- Bond issuance costs and underwriting
- Loan origination fees that are amortized over the perm loan period
- Probably no insider payments -- development fees



50% Financing Requirement

- If $\geq 50\%$ of the aggregate basis is “financed by” bond proceeds, no tax credit allocation necessary and building basis eligible for LIHTC “4% credit”
- If $< 50\%$ is “financed by” bond proceeds, only the portion of eligible basis that is bond-financed qualifies for LIHTC
- To count as “financed by” bonds:
 - » Costs must be incurred after 60 days prior to inducement resolution and before placed in service
 - » Bonds must be outstanding at least until placement in service



50% Financing Requirement

- Aggregate Basis for 50% test:
 - » Includes both land and building
 - » Different from LIHTC basis (building-only)
 - » Excludes permanent loan fees and interest, intangible assets, cash reserves and lease-up costs



50% Test

Tax-exempt
bonds +
Interest Earned

≥ 50%

“Aggregate
Basis” (land
& building)

50% Test

Compare good money from
bonds, including interest earned

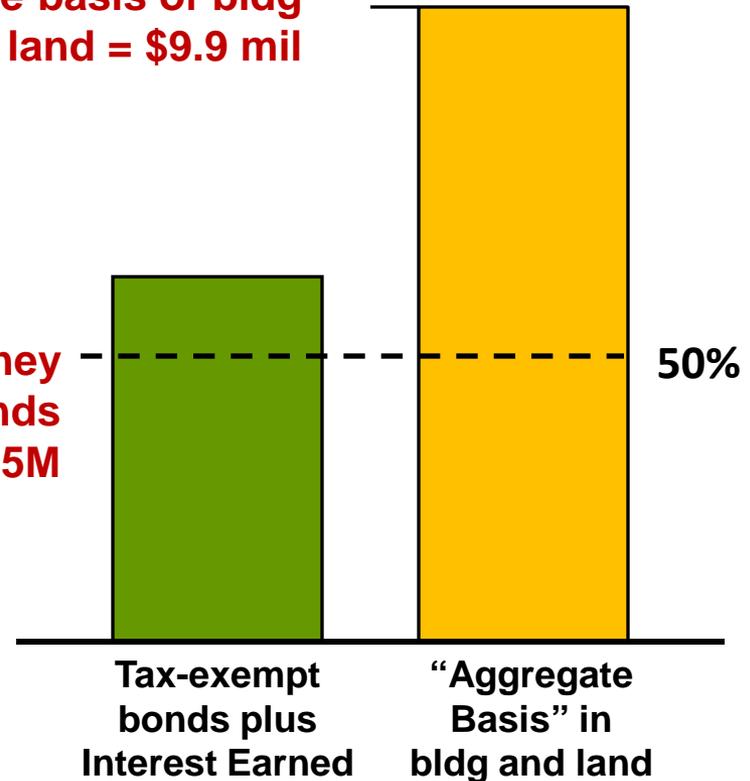
To

Aggregate basis of building
and land

$$5 / 9.9 = 50.5\%$$

Aggregate basis of bldg
and land = \$9.9 mil

Good money
from Bonds
is \$5M



Glossary

Glossary

- **Bond Counsel:**

Attorney representing the bond issuer and bondholders. The attorney provides an opinion that the interest on the bonds is exempt from federal taxation. Responsible for the bond inducement resolution, bonds, the bond indenture, the financing agreement, the regulatory agreement and the tax opinion.



Glossary

- **Inducement Resolution:**

A resolution passed by the bond issuer communicating the intent to issue bonds for a specific activity.

- **Official Statement:**

The marketing prospectus used by underwriters to sell the bonds (in a public offering). The official statement summarizes the terms of the bonds and other information relevant to the investment decision.



Glossary

- **Arbitrage Rules:**

Very technical rules which primarily limit the amount of money that can be pledged as security for the bonds

- **Bond Issuer:**

Governmental or Non-Profit entity responsible for issuing the bonds.

- **Credit Enhancer:**

For fee, guarantees that the bondholders will receive scheduled bond payments.



Glossary

- **Indenture:**

An agreement between the bond issuer and the trustee containing the terms and procedures for payment of the bonds.

- **Rating Agency:**

Agencies that determine or “rate” the investment risk of the bonds. Examples include Standard & Poor’s and Moody’s Investor Services.



Glossary

- **Regulatory Agreement:**

An agreement entered into between the borrower, the bond issuer and the trustee specifying the income rent and income restrictions a project owner must comply with for the bonds to retain their tax exempt status.

- **TEFRA Hearing:**

The bond issuer's public notice, public hearing and approval by elected officials of a bond issuance.

- **Underwriter:**

An investment bank that underwrites and markets the bonds to investors.



Tax Structuring

Tax Ownership

- LIHTCs only available to “owners” of the Project Partnership.
- Several factors for “ownership” for tax purposes:
 - » Possesses both the benefits and burdens of ownership
 - » Purchase price is at fair market value
 - » Liabilities do not exceed fair market value
 - » Purchase options at fair market value
 - » Title policy covering entire basis (permanent loans + capital contributions of all partners + deferred developer fee (i.e., entire sources less reserves))



Depreciation: 168(h) Elections

- Tax-exempt partners (e.g. non-profits or foreign entities) or tax-exempt controlled partners may subject project to tax-exempt use property rules
 - May result in Alternative Depreciation System (ADS - 40 year depreciation rather than 27.5)
 - Resolve with either “qualified allocations” or “168(h) election” by the tax-exempt controlled entity.
 - 168(h): Election to be treated as taxable
 - If not already corporation (i.e., LLC), first need to elect to be treated as a corporation
 - Timing: with tax return for year placed in service
 - Qualified allocations: same % of *all* items of income, gain, loss, deduction, credit, & basis



Depreciation: Site Improvements

- Site Improvements versus Permanent Land Improvements
 - » Site Improvements –
 - » Include paving, sidewalks, perimeter landscaping, grading to make the building possible.
 - » **Includable in Eligible Basis and depreciable over 15 years.**
 - » Permanent Land Improvements –
 - » Grading and other permanent changes to land that are not related to the specific buildings and would benefit subsequent uses of the Property, e.g., retainage ponds, retainer walls landscaping outside building perimeter, berms, etc.
 - » **Not includable in Eligible Basis and not depreciable property.**



Debt Characterization

- Debt must be “true debt” to be respected for tax purposes.
- Soft Debt Issues
 - » Residual Value Analysis
 - » Preferred terms:
 - › Maturity at same time as other debt
 - › Fixed interest rate



Implication of Grants

- Grants
 - » To Project Partnership -
 - › Grants are taxed as income
 - › Note: Property acquisition at below-market price may be treated as a grant to the project partnership, taxable as income
 - » To non-profit partners which then loan or contribute funds to the Project Partnership
 - Concern: recharacterization as disguised grants
 - Preferred terms:
 - Interest rate @ AFR
 - Secured by mortgage
 - No forgiveness



Deferred Developer Fee

- Preferred terms:
 - » Interest rate at AFR
 - » Term <15 years
- Residual Value Analysis - Must be fully paid during the Compliance Period (or sooner)
- Depreciation of Deferred Developer Fee - Depreciation of unpaid portion of fee is suspended until paid



Partnership Basis and Allocations

- Partnership Basis
 - » LIHTC's are allocated to the partners of a Partnership in the same manner as depreciation losses are allocated.
 - » Therefore, in order to claim the LIHTCs, a partner must be allocated the losses
 - » General Rules
 - › A partner may only be allocated losses with respect to a property up to the amount of its basis in a property.
 - › A partner's basis is generally equal to a partner's capital account plus its share of partnership liabilities.



Partnership Basis and Allocations

- Partner's Share of Liabilities - Non-Recourse Debt
 - » If a partner bears the economic risk of loss with respect to any liability that partner must include that liability in its basis.
 - » Having the general partner bear the economic risk of loss with respect to a liability can cause a reallocation of losses and credits away from the investor to the general partner
 - » Whether a partner bears the economic risk of loss with respect to a liability will depend on whether the liability is characterized as “partnership nonrecourse debt”



Partnership Basis and Allocations

- Nonrecourse Debt
 - » **Partnership** Nonrecourse Debt: no partner (or person related to a partner) bears the risk of loss
 - » **Partner** Nonrecourse Debt:
 - » made or guaranteed by a partner (or related party)
 - » otherwise “nonrecourse” under Treasury regulations
 - » 10% de minimis rule for “ordinary course” lenders
 - » Basis with respect to **partnership** nonrecourse debt must be allocated to the partners in the same way as other partnership items- e.g. 99.99% to the ILP
 - » Basis with respect to **partner** nonrecourse debt must be allocated to the partner bearing economic risk of loss.



STRUCTURING CONCERNS TRAPS FOR THE UNWARY

- Partnership Allocations:
 - Allocation of income, gains, losses and deductions must have “substantial economic effect” to be respected for tax purposes.
 - » Key factors: capital account calculation and maintenance, distribution of proceeds of liquidation, methods to deal with negative capital accounts
 - » Potential reallocation of credits
 - » Related party debt
 - » Generally, $\geq 80\%$ common ownership
 - » Acquisition credits: $\geq 50\%$ common ownership (aggregate)
 - » Residual analysis (debt vs. property value)



Additional Structuring Concerns

- Tax-Exempt Use Property (see
- Seller Financing
 - Interest rate (AFR)
 - Commercially reasonable terms
- Public Sources of Funding
 - Tax-exempt bond-financed soft debt
 - Exclusion from basis
 - Loans vs. grants
- 130% basis boost – location in a QCT or DDA at the time of the tax credit application
 - Not available in tax-exempt bond financed transactions





Structuring and Documenting Low-Income Housing Tax Credit Deals

D. Hara Sherman

hsherman@goulstonstorr.com

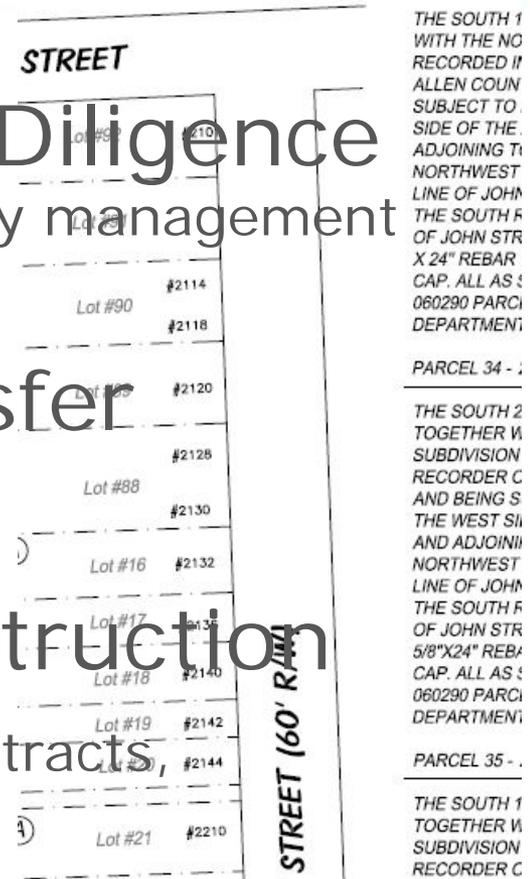
(212)-878-5129

goulston&storr

goulstonstorr.com

It's still a real estate deal

- Customary Real Estate Due Diligence (title, survey, zoning, environmental, property management documents, appraisal, market study...)
- Customary Real Estate Transfer Documents (contract, deed...)
- Customary Real Estate Construction Documents (permits, construction contracts, insurance...)



Key Allocating Agency Documents

- Tax Credit Application
- Tax Credit Reservation Letter
- Carryover Allocation and 10% Test
- 42(m) Letter/Determination Letter
- Regulatory Agreement

Key Allocating Agency Documents

- **Tax Credit Reservation Letter** – project must be placed in service in this year, unless it obtains a carryover allocation
- **Carryover Allocation** – carryover allows project to be placed in service no later than the end of the 2nd year after the issuance of the reservation letter if it meets the 10% test
- **10% Test** – for a carryover to be valid, must incur at least 10% of the project's reasonably expected basis within the later of 6 months after the allocation or the close of that calendar year (acquisition costs, construction costs, developer fee, service providers, debt service)

Key Allocating Agency Documents

Pat Dymally Governor



ILLINOIS HOUSING DEVELOPMENT AUTHORITY

CONDITIONAL RESERVATION LETTER

[REDACTED] (the "Owner")

Re: Project Name: [REDACTED]
 Project Location: [REDACTED]

IHDA Tax Credit No.: [REDACTED]
 Credit from Allocation Year(s): [REDACTED]
 Allocation Type (NC, R, A/R): NC
 Unit Count: 65/67
 Applicable Fraction: 100%
 Completion Date: [REDACTED]
 Minimum Low Income Election: 40/60
 Reservation Amount ("Reservation"): [REDACTED]
 Reservation Fee ("Reservation Fee"): [REDACTED]
 Non Profit Set-Aside Reservation: Yes No
 Date by which 10% test must be met: [REDACTED]
 Date 10% test documentation due: [REDACTED]

Dear Owner:

The Illinois Housing Development Act, 20 ILCS 3805/1 *et seq.*, as amended from time to time (the "Act"), designates the Illinois Housing Development Authority (the "Authority") as the low income housing tax credit agency for the State of Illinois (the "State") to allocate federal low income housing tax credits ("Tax Credits") to housing projects that satisfy the requirements set forth in Section 42 ("Section 42") of the Internal Revenue Code of 1986 (the "Code") and the regulations of the U.S. Department of Treasury and Internal Revenue Service ("IRS") promulgated thereunder, as amended from time to time (the "Regulations"), and the rules and regulations of the Authority codified at 47 Ill. Adm. Code Part 350, as amended from time to time (the "Rules"). Subject to the

¹ The number of low income units/The total number of units in the Project.

² This credit amount has been calculated using an estimated qualified basis and an estimated applicable percentage. While the actual qualified basis and applicable percentage may change, the reservation amount cannot be exceeded.

terms and conditions set forth in this Conditional Reservation Letter (this "Letter"), the Authority agrees to reserve Tax Credits in the amount of the Reservation for allocation in connection with the real estate legally described in Exhibit A attached hereto and made a part hereof, and the improvements located or to be located thereon (the "Project"). No change in the Owner or, as applicable, general partner(s) or managing member(s) of the Owner shall occur prior to issuance of Form 8609 for the Project without the prior written consent of the Authority.

I. TERM FOR ACCEPTANCE

The terms and conditions of this Letter shall become effective as of the date of this Letter, provided that the Owner accepts it by executing this Letter in the spaces indicated by [REDACTED] and returning it to the Authority, together with the Reservation Fee indicated above, no later than [REDACTED]. Failure to return this Letter by [REDACTED] may result in forfeiture of the Reservation for the Project. The Reservation Fee is equal to 6.5% of the Reservation amount, as calculated based on 3.5% and/or 9% respectively as required by the Authority's Qualified Allocation Plan (the "QAP").

This Letter is conditioned on the Owner's constructing, rehabilitating or acquiring and rehabilitating, as applicable, the Project in accordance with the application for Tax Credits (the "Application") submitted to the Authority and is subject to the Owner and the Project maintaining eligibility under all selection criteria. The Owner acknowledges that it has an affirmative obligation to advise the Authority of any changes to such Application.

II. GENERAL CONDITIONS

Performance by the Authority of its obligations under the Letter is contingent on the following:

1. the Authority's continued designation as the Tax Credit agency for the State;
2. the Authority's continued ability to comply with Section 42 and other applicable sections of the Code, and the applicable Regulations; and
3. the Authority's determination that the allocation of Tax Credits is not greater than the amount necessary for the financial feasibility of the Project at the time the Project is placed in service.

III. SPECIAL CONDITIONS

A. This Conditional Reservation of Tax Credits is expressly conditioned on the Authority's determination that the Project is able to proceed in a timely fashion, as set forth more fully below. If the Authority determines that the Project is unable to proceed in a timely fashion, the Conditional Reservation of Credits will be revoked.

The American Recovery and Reinvestment Act of 2009 (Public Law 111-5) (the "Recovery Act")

Key Investor Documents

- Partnership Agreement
- Operating Deficit Guaranty
- Construction Completion Guaranty
- Repurchase Guaranty
- Development Agreement
- Asset Management Agreement
- Tax opinion

Key Investor Documents

Partnership Agreement

- **Capital Contributions** – timing of equity pay in
– not unusual to see: closing (15%); 50% complete (20%),
conversion (50%), stabilization (15%)
- **Allocation of Profits, Losses, Credits**
- **Reserves** – timing of funding and amount – often see
6 months for operating reserves
- **Powers/Duties of GP**
- **Removal of GP**

Key Investor Documents

Guaranties

- **Construction Completion** – often unlimited
- **Operating Deficit** – often capped and time-limited, 5-7 months of operating expenses, 5 years after stabilization
- **Tax Credit** – often all paid in equity plus expenses for entire compliance period for certain identified events

Key Investor Documents

Development Agreement

- **Industry standard** – 15% project costs
- **QAP** - guidance in allocating agency's qualified action plan or disclosed in tax credit application?
- **Timing and Deferral** – funded at which contribution; deferral through stabilization or compliance; deferral paid from cash flow

Key Investor Documents

Tax Opinion

- Analysis of debt
- Analysis of allocations
- Analysis of credits

HUD and Other Federal Financing

Stafford Webinar

June 12, 2014

Roberta L. Rubin

Klein Hornig LLP

617-224-0609

rrubin@kleinhornig.com



HOME Investment Partnerships Program

- Title II of Cranston-Gonzalez National Affordable Housing Act (Regulations: 24 CFR Part 92)
- Exclusively for housing but flexible
 - Homeownership development
 - Multifamily rental housing development
 - Rental assistance
 - Homebuyer assistance



Community Development Block Grant Program

- Housing and Community Development Act of 1974 (Regulations: 24 CFR Part 570)
 - Serving many community needs, including public facilities & improvements, code enforcement
 - Housing, but with limitations
 - New construction only eligible under limited circumstances, including “last resort” housing and neighborhood revitalization projects carried out by CBDOs
 - Acquisition, materials purchase, rehabilitation



Block Grants – Common Themes

- Annual grants to States and local jurisdictions
 - “entitlement” and “non-entitlement” communities
 - Formula allocations
- Project may receive HOME and/or CDBG funding from state and locality
- Cross-cutting Federal requirements (see below)



Block Grants – Key Differences

- Permitted uses
- Affordability (income & rent)
 - CDBG:
 - If 2 or more units, at least 51% of units \leq 80% AMI
 - OR new construction of multifamily (nonelderly), at least 20% of units \leq 80% AMI, and proportion of affordable units/total \geq proportion CDBG/total \$\$
 - HOME:
 - “High Home” – 80% of units \leq 65% AMI
 - “Low Home” – 20% of units \leq 50% AMI



Neighborhood Stabilization Program

- NSP1 (HERA), NSP2 (ARRA), NSP3 (Dodd-Frank)
- Acquisition and development of foreclosed, abandoned and vacant properties (also demolition)
- Time limited (obligation/expenditure)
- CDBG rules apply except where otherwise specified
 - Heavy reliance on informal guidance



“Mixed-Finance” Development

- HOPE VI
- Public Housing Capital Funds
- Replacement Housing Factor Funds
- Rental Assistance Demonstration Program
- Choice Neighborhoods (PH or HUD-assisted)
- Common themes:
 - Public/private partnerships
 - Focus on revitalization of distressed public housing (or HUD-assisted housing in Choice)



Other HUD Grant Programs

- 202 (Elderly Housing)
- 811 (Persons with Disabilities)
- McKinney-Vento (Homeless)
- Common themes:
 - Targeted populations
 - Capital funds bundled with rental assistance
 - Programs often present challenges when combined with LIHTC



HUD Mortgage Insurance Programs

- 221(d)(4) (new development or substantial rehab of multifamily housing)
- 223(f) – acquisition/refinance of multifamily housing, no substantial rehab
- 223(f) – Refinancing of existing project, whether or not prior HUD financing
- 223(a)(7) – Refinance of existing HUD debt
- Risk-Sharing (HFA loans – may be coupled with bond financing)



HUD Mortgage Insurance Programs (continued)

- Common themes:
 - Multifamily Accelerated Processing (MAP) lender handles much of processing, initial underwriting, advances funds for most HUD-insured loan programs
 - MAP Guide (Handbook 4430.G), Multifamily Program Closing Guide
 - For Risk-Sharing, Handbook 4590.01, CFR
 - Two-step closing (lender, then HUD)
 - Timing issues



Additional Federal Programs

- USDA – Section 515 of Housing Act of 1949 (42 USC 1485) – loans for development of low or moderate income housing in rural areas
- FEMA – programs for demolition/relocation/development in areas affected by natural disaster
- Brownfields



Cross-Cutting Federal Requirements

- Davis-Bacon Wage Act
 - Applicability varies by program
 - HOME: ≥ 11 HOME units
 - CDBG: ≥ 8 units in project
 - Public housing or project-based Section 8 – applicable
- Environmental Clearance
 - Restriction on “choice-limiting activities”
 - Responsible entity
 - Request for Release of Funds/Finding of No Significant Impact



Cross-Cutting Federal Requirements (Continued)

- Fair Housing/Section 504
- Lead-Based Paint
- Contracting
 - No debarred/suspended, ineligible contractors
 - Employment and contracting opportunities (Executive Orders, Section 3)
- Uniform administrative requirements
 - OMB circulars
- Uniform Relocation Act



For more information contact:

Roberta L. Rubin
Klein Hornig LLP
101 Arch St., Suite 1101
Boston, MA 02111
rrubin@kleinhornig.com
617-224-0609



Green Sources of Financing

- Requirements in Qualified Action Plan
- Fannie Mae Green Preservation Plus
- Local Energy Efficiency Retrofit Loans
- Nonprofit Sources

For more information, please contact:



D. Hara Sherman

hsherman@goulstonstorrs.com

(212)-878-5129