The Low Income Housing Tax Credit: An Introductory Overview

Presentation to the WCHC Technical Review Committee

June 8, 2021

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Low Income Housing Tax Credit (LIHTC)

- The LIHTC is a federal tax incentive to to construct or rehabilitate affordable rental housing for low-income households.
- It was enacted in 1986 as part of the Tax Reform Act of 1986 as a way to encourage private investment in affordable housing development and rehabilitation.
- The credit provides investors with a dollar-for-dollar reduction in federal tax liability and can be claimed annually for 10 years.
- LIHTC eligible rental properties include apartment buildings, single-family dwellings, townhouses, and duplexes.

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Low Income Housing Tax Credit (LIHTC)

- Owners or developers of projects receiving the LIHTC agree to meet an income test for tenants and a gross rent test. There are three ways to meet the income test:
  - At least 20 percent of the project's units are occupied by tenants with an income of 50 percent or less of area median income adjusted for family size (AMI).
  - At least 40 percent of the units are occupied by tenants with an income of 60 percent or less of AMI.
  - At least 40 percent of the units are occupied by tenants with income averaging no more than 60 percent of AMI, and no units are occupied by tenants with income greater than 80 percent of AMI.
- There are two types of credits: a 9% competitively awarded credit and a 4% automatic allocated credit.
- Tax credits are allocated through the State Housing Finance Agency under their Qualified Allocation Plan

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4% and 9% LIHTC

The **4% LIHTC** subsidizes approximately 30% of the costs associated with the low-income units in a project.

It is used for:

The acquisition of existing buildings

The rehabilitation or new construction of housing financed by tax-exempt bonds (federally subsidized)

The **9% LIHTC** subsidizes approximately 70% of the costs associated with the low-income units in a project.

States receive a limited-amount of competitive 9% credits to allocate annually.

It is used to finance the substantial rehab or new construction of low-income units

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How does LIHTC generate equity?

- Developers are awarded an allocation of tax credits that are sold to an investor.
- The amount of credit awarded is tied to the project's eligible-basis, the percentage of low-income units in the project, and whether the project qualifies for a "basis boost."
- The investor pays the developer a price per credit based on their desired yield for the investment, present value of their future stream of benefits, and other factors.
- The payments are received as equity installments during the construction and stabilization of the housing project and are provided upon the project meeting certain negotiated milestones.
- In return for the investment, the investor becomes a limited partner in the project and receives a dollar-for-dollar federal tax credit annually for 10 years.

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Example: Equity Calculation

- Developer X receives a 9% LIHTC reservation of $100,000 for a 100% low-income project that is not eligible for a basis boost.
- Investor Y prices the LIHTC at $.90

Equity = $100k LIHTC/year x 100% fraction x 9% applicable percentage x 99.99% ownership x 10 years = $899,910

- Developer X receives a 4% LIHTC reservation of $100,000 for a 100% low-income project that is eligible for a basis boost.
- Investor Y prices the LIHTC at $.90

Equity = $100k LIHTC/year x 130% basis boost x 4% applicable percentage x 99.99% ownership x 10 years = $519,948

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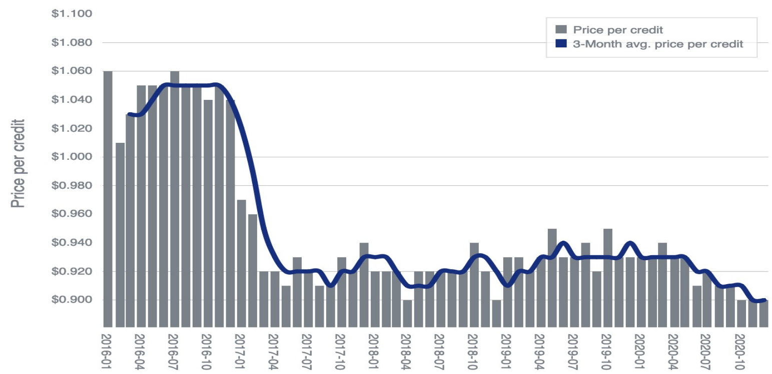
Impacts: LIHTC Pricing Trends



Disclaimer: This low-income housing tax credit equity pricing chart is presented for general information purposes only. Per credit equity pricing is based on syndicator Letter of Intent (LOI) pricing provided to Novogradac by market participants. The equity price reported for each month is the average equity price for LOI pricing data issued in that month. No adjustments to equity pricing are made for timing of capital contributions or other considerations. Data is rounded to the nearest cent.

Source: Novogradac

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Impacts: LIHTC Pricing Trends

- Based on Novogradac data:
  - 3-Month Average LIHTC price in December 2019 = $.94
  - 3-Month Average LIHTC price in December 2020 = $.90
  - Assume $850,000 LIHTC Reservation
    - Equity Raised in December 2019 = $7,989,201
    - Equity Raised in December 2020 = $7,649,235
    - Difference of $339,966

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Impacts: Fixing of the 4% LIHTC rate

The Consolidated Appropriations Act of 2021, under Section 42(b)(3), requires that the applicable percentage for LIHTC allocations made after December 31, 2020, shall not be less than 4%.

- Developer X receives a 4% LIHTC reservation of $500k for a 100% low-income project that is eligible for a basis boost.
- Investor Y prices the LIHTC at $.90

Equity = $500k LIHTC/year x 130% basis boost x 4% applicable percentage x 99.99% ownership x 10 years = $2,599,740

Previously:

- Developer X receives a 4% LIHTC reservation of $500,000 for a 100% low-income project that is eligible for a basis boost.
- Investor Y prices the LIHTC at $.90

Equity = $500k LIHTC/year x 130% basis boost x 3.15% applicable percentage x 99.99% ownership 10 years = $2,047,295

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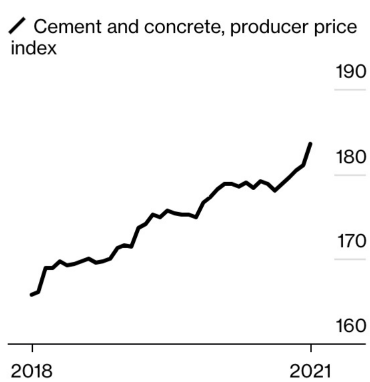
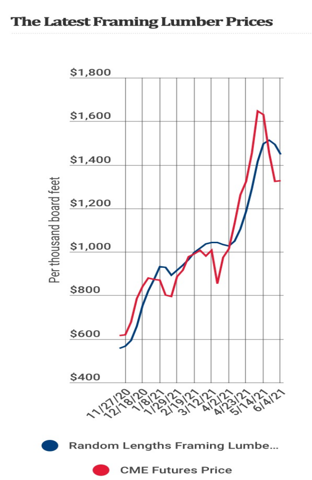
Impacts: Construction Pricing Trends



Source: Bloomberg



Source: National Association of Homebuilders

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State of Nevada LIHTC Process: 9% credit

- Credits are allocated one time per year
- Applications are submitted in May
- Reservations are typically received by July
- Developers garner points by selecting preference points in various categories to win an award
- Credits are apportioned into set asides:
  - Non-profit
  - USDA
  - Additional Credits
  - Geographic based on population
    - Clark (73.67%)
    - Washoe (15.09%)
    - Balance of Counties (11.24%)

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State of Nevada LIHTC Process: 4% Credit with Tax Exempt Bonds

- Receive up to 50% of requested bond amount or Resolution of Support from local jurisdiction
- Submit application to Nevada Housing Division (NHD) for remaining bond authority
- Applications can be submitted at any time and bonds are reserved on a first come, first served basis
- Eligible projects receive the automatic 4% LIHTC to provide private equity into the project
- Less bond projects means Nevada is leaving federal funding/private leveraging on the table

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HOME Funds and LIHTC

Affordable housing projects have many layers of financing

HOME funds allocated by the WCHC are an important source of *gap financing* for LIHTC projects

- Gap funds provide flexible financing and typically do not require an annual hard-debt payment
- HOME and LIHTC rents and income restrictions can be layered onto the same unit
  - For example, Unit 1 in Building A can be a 50% AMI LIHTC restricted unit and a Low HOME unit
- Developers must comply with HOME and LIHTC underwriting and compliance requirements

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HOME Funds and LIHTC

Sources

	Amount	Rate	Amort
Permanent Mortgage	-	4.50%	30
GP Contribution	100	0.00%	30
WCHC HOME/HTF	1,285,004	3.00%	30
NHD NHTF	465,000	3.00%	40
Limited Partner Equity	8,553,145	0.910	
Def. Dev. Fee	267,397	3.00%	15
Total Sources	**10,570,646**		

Uses	Amount
Acquistion	600,000
Hard Costs	7,085,875
Soft Costs	1,913,857
Fees/Reserves	970,914
Total Uses	**10,570,646**

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HOME Funds and LIHTC

- In Nevada, HOME funds are also tied to the property tax exemption which allows for projects to:
  - Decrease annual operating costs and, thereby, support more debt and/or maintain required Income-to-Expense or Debt Service Coverage ratios
  - Deeper income target
  - Jurisdiction uses it to provide HOME match
- The HOME funds must be committed for investors and lenders to include the property tax exemption and gap financing in their underwriting
- On a bond project, the property tax exemption can leverage several million additional dollars

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HOME Funds and LIHTC

Example: Permanent mortgage at 3.81% interest rate, 35-year amort, and 1.2 DSC

Base Year Rental Revenue	2,028,588
Ancillary Base Year Rental Revenue	31,492
Base Year Expenses (less fee)	703,726
Management Fee	58,712
First Mortgage Debt Service	976,977

- With an estimated $158k in annual property taxes, annual expenses increase to $861,726 and supportable debt decreases from $18.87M to $16.87M creating a $2M gap in financing

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