LAYING THE FOUNDATION FOR A BETTER FUTURE

2018 OHIO HOUSING CONFERENCE
NOVEMBER 6 - 8, 2018

Tax Credits 101

Wednesday, November 7
10:45am – 12:00pm

Today's Panel

- Kevin Clark
  Ohio Housing Finance Agency (OHFA)
- Brian Graney
  Ohio Capital Corporation for Housing
- Meg Manley
  PIRHL, LLC
- Tim Swiney
  Wallick Communities

Agenda

- Introduction to the tax credit
- Public-private partnership
- What you can build
- Income and rent restrictions
- Calculating the tax credit
- Development process
- Sample properties

A couple questions for you…

- What part of the affordable housing field do you work in?

- How long have you worked in the affordable housing industry?

Ground Rules

- Provide basic information about the Tax Credit Program
- Questions and comments are encouraged!
- Describe acronyms and jargon
- Housekeeping items

What is the tax credit program?

- Low-Income Housing Tax Credit (LIHTC)
- Federal subsidy to finance development of affordable rental housing
- Created under the Tax Reform Act of 1986
  - Bipartisan support

What is the tax credit program?

- Federal oversight by Internal Revenue Service (IRS)
  - Section 42 of Internal Revenue Code

IRS

- Administered by Housing Finance Agency in each state (including OHFA)

OHIO HOUSING FINANCE AGENCY

Role of IRS

- General guidance and rules for the program
  - Compliance period = 15 years

- Award tax credits annually to each state based on population

Role of Housing Finance Agencies

- Adopt and implement the Qualified Allocation Plan (QAP)
  - Document that establishes program guidelines
  - OHFA develops an Annual Plan and Needs Assessment to help determine priorities
  - OHFA provides several opportunities for public input and feedback

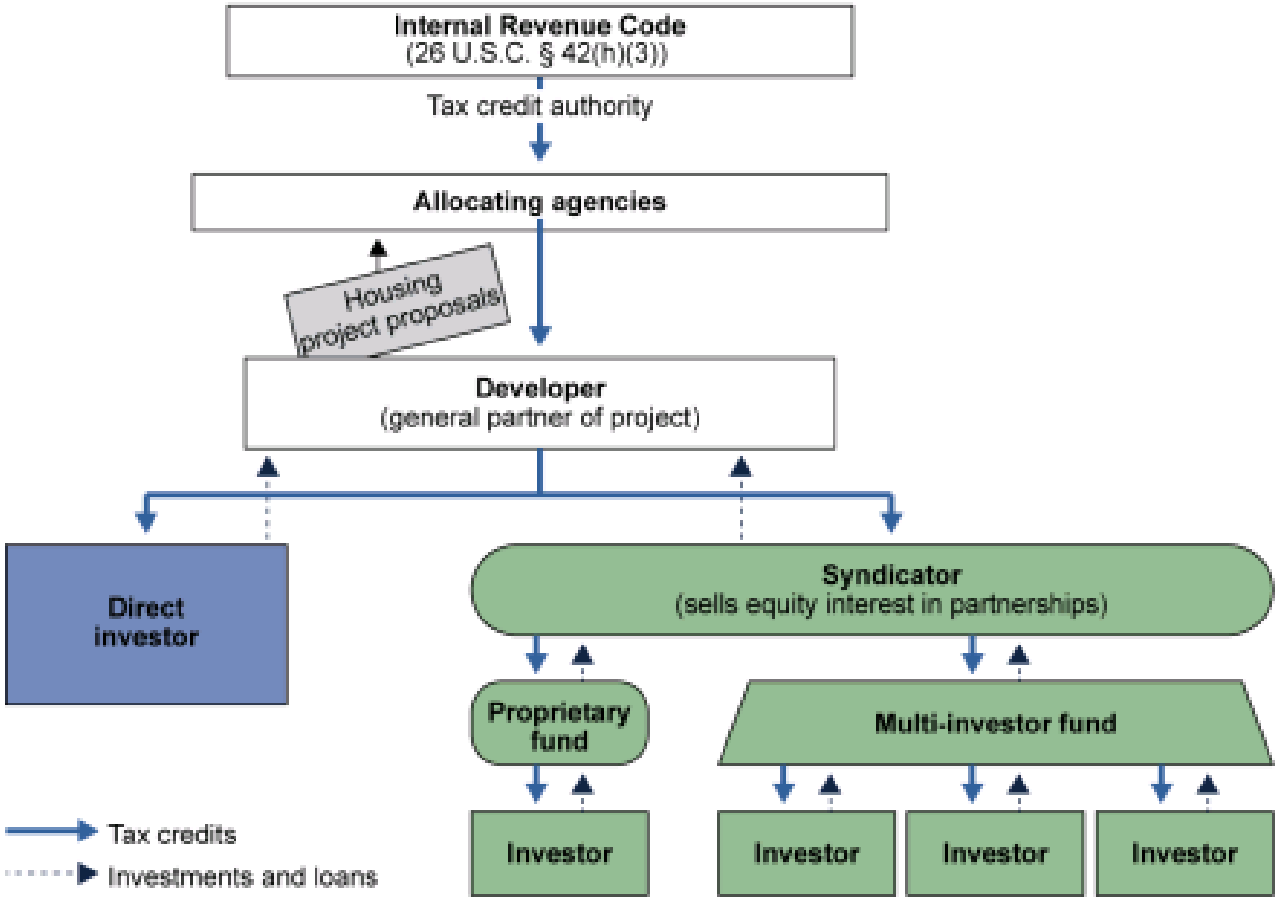
Role of Housing Finance Agencies

- Accept and review applications
- Award tax credits to proposed developments
- Financial analysis
- Construction monitoring
- Compliance monitoring
  - 30 years for each property

LIHTC as Public-Private Partnership

- Tax credits allocated by state agencies to private real estate developers to build affordable housing
- Private Investors (banks/financial institutions) purchase tax credits to provide equity necessary for construction
  - Can be direct investment in a single project or through a syndicated multi-project fund

LAYING THE FOUNDATION FOR A BETTER FUTURE



Source: GAO. | GAO-17-285R

Why Invest in Tax Credits?

- LIHTC provides dollar-for-dollar reduction in income tax liability
- LIHTC projects also generate operating losses
  - Flow through to the investors to further lower tax liability
  - Losses are only as valuable as an investor's tax rate
- Private market where the price paid (equity pricing) and the investor's return (IRR) should be equilibrium

Private Investors Role

- Investors are incentivized to maintain the project's affordability
  - Credits can be recaptured if property is not affordable during 15-year compliance period

What can you build with the tax credit?

- Apartments for individuals, families or seniors
- Single-family rental homes

- Supportive housing for individuals with special needs (such as homeless or disabled)

What can you build with the tax credit?

- New affordable units
  - New construction
  - Renovation of existing buildings
- Preservation of existing subsidy
- Market rate housing and/or commercial space may be included
  - Tax credits only apply to affordable units

Income restrictions

- Units rented to households earning less than 60% of area median income (AMI)
- Median income calculated for each county
- Example: Franklin County
  - 60% income level for an individual = $32,100
  - 60% income level for a family of four = $45,840

Rent restrictions

- Rents affordable to households earning less than 60% of AMI
- Calculated based on bedroom size (not the income of each household)
- Includes allowance for tenant-paid utilities
- Example: Franklin County
  - 60% rent for a one-bedroom unit = $860
  - 60% rent for a four-bedroom unit = $1,330

Rent and income restrictions

- States may require set-asides for very low- or extremely low-income households
- Rent and income restrictions in place for 30 years (restrictive covenant)
- Income Averaging
  - Some units may be affordable to and occupied by households earning up to 80% of AMI
  - Average of all units must be at or below 60% of AMI

Calculating the Tax Credit

- Eligible Basis
  - To determine the amount of tax credits a project qualifies for, state allocating agencies first determine Total Development Cost
  - Non-depreciable costs (such as land and reserves) are subtracted to determine *Eligible Basis*

Calculating the Tax Credit (continued)

- Eligible Basis may receive up to a 30% boost if:
  - Project located in HUD-designated Difficult Development Area (DDA) or Qualified Census Tract (QCT)
  - Project designated by state agency
- If a project qualifies for either, then more of the cost is subsidized by the tax credit program
- HUD designations made by comparing incomes to housing costs

Calculating the Tax Credit (continued)

- Qualified Basis
  - Eligible Basis then multiplied by applicable fraction to determine *Qualified Basis*
  - Applicable Fraction: % of low-income units or % of low-income square footage (whichever is less)

Calculating the Tax Credit (continued)

- Qualified Basis then multiplied by applicable tax credit percentage
  - Two options: 9% (fixed) or 4% (floating)
  - 9% projects are competitively awarded (new construction or rehabilitation)
  - 4% projects are financed with tax-exempt bonds (usually rehabilitation)

Example #1: Tax Credits for a 9% Project

- Assume a 9% project has $1 million of qualified basis
- The project then generates $90,000 in annual tax credits
  - 9% x $1 million
- $90,000 in tax credits are generated each year for 10 years, for **$900,000** in total tax credits

Example #2: Tax Credits for a 4% Project

- Assume the same $1 million qualified basis
- This time it is a 4% tax-exempt bond project
- The project then generates $40,000 in annual tax credits
  - 4% x $1 million
- $40,000 in tax credits are generated each year for 10 years, for **$400,000** in total tax credits

Sources of Financing

- Debt and Equity
- Equity comes from the sale of LIHTC to investors
- Equity typically a larger portion of the financing
  - Rents are restricted, so project cannot support higher levels of debt
  - Equity pricing = $ price paid per credit

Permanent Financing

- With rental restrictions, permanent mortgages are limited in size compared to market rate housing.
- "Hard debt" typically refers to debt that must be repaid
- "Soft debt" typically refers to debt where payment can be deferred, paid out of surplus cash flow, or forgiven

Gap Financing

- Grants (HOME funds, FHLB AHP, trust funds)
- Secondary Loans – "Soft Debt" – repayment is contingent on project's cash flow
- Deferred Development Fee
  - Unanticipated cost overruns
  - Risk if the project has too much deferred fee

Tax Credit Development Process

- Create a project concept that meets QAP priorities
- Find location
  - Secure site control
  - Market study
  - Does zoning permit the project?

- Discuss proposal with local government & partners

Tax Credit Development Process

- Assemble development team
  - Developer
  - General partner(s)
  - Syndicator/Investor
  - Architect
  - General contractor
  - Property manager
  - Other professionals (Accounting, Legal, etc.)

Tax Credit Development Process

- Design planning
- Pre-development site work
  - Survey or other engineering
  - Environmental report
- Examine financial feasibility (rents, cost to develop and to operate, financing sources)
- Confirm interest by lender and investors
- Submit application(s) for tax credits and other financing

Tax Credit Development Process

If tax credits are awarded…

- Submit additional materials to HFA
- Meet "Carryover" requirements (acquire site, "10% test")
- Close on equity and debt financing
- Construction
- Lease-up and Operations

LAYING THE FOUNDATION FOR A BETTER FUTURE

2018 OHIO HOUSING CONFERENCE
NOVEMBER 6 - 8, 2018

pirhl

Proctor's Landing

Proctor's Landing

- Lawrence County, Ohio
- 56-units
- Senior Housing
- Enhanced Supportive Services
- Greywater Recycling System

- PIRHL was the co-developer and General Contractor

- Owner, Property Manager and Supportive Service Provider: Ironton-Lawrence County Community Action Organization

Creative Design Feature:

- Greywater Recycling System
- Captures Water from Showers and tubs that is filtered for toilet flushing
- Over 228,000 gallons of water is recycled annually
- Operational Costs Savings of over $56,000 in water costs will be realized over 15 year compliance period

Financing Structure:

Lawrence County Port Authority	$300,000
OHFA HDAP	$750,000
Tax Credit Equity (OCCH)	$8,173,843
Equity Bridge Loan Interest	$173,094
Federal Home Loan Bank AHP	$592,010
Member Bank Contribution	$500
Sponsor Contribution	$500
Deferred Developer Fee	$245,241
TOTAL	**$10,235,188**

LAYING THE FOUNDATION FOR A BETTER FUTURE

2018 OHIO HOUSING CONFERENCE
NOVEMBER 6 - 8, 2018

WALLICK Communities

Cypress Commons Apartments

Cypress Commons Apartments

- City of Middletown, Butler County, Ohio
- 44-units
- Family Housing
- Enhanced Supportive Services
- New Construction of Club House

- **Developer / General Contractor / Property Manager:**
  Wallick Communities

- **Architect:**
  Hooker DeJong Architects

- **Supportive Service Provider:**
  Resident Resources Network, Inc.

Creative Design Features:

- **Over $60,000 per unit of improvements, which included:**
  - Demo & New Construction of 2,200 sqft. Club House
  - Enterprise Green Communities Certification
  - Significantly Enhanced Accessibilty & Visitibility Throughout the Entire Site.
  - New Playground Equipment Amenities Provided.
  - Hard-Surface Flooring Throughout the Entire Unit.
  - New Central HVAC Systems (removed previous Thru-wall A/C & Baseboard Heating)

Financing Structure:

Ohio Preservation Loan Fund (Construction Loan):	$3,274,200
RiverHills Bank (Permanent Loan):	$965,000
Tax Credit Equity (OCCH):	$4,734,502
Equity Bridge Loan Interest	$162,615
MRN/CRN Mortgage Assumptions:	$815,818
Transferred Reserves:	$190,000
Deferred Developer Fee:	$251,600
TOTAL PROJECT SOURCES:	**$10,393,735**

Program Benefits

- Add to affordable housing stock
- Meet mission in the community
- Serve selected target populations
- Earn development fees
- Potential for management fees and cash flow
- Potential long-term ownership

Program Results

- Tax credits have assisted with the development of more than 100,000 affordable rental units in Ohio since 1987.
- Tax credits have financed roughly 3 million units for low-income households nationwide, adding approximately 100,000 units to the inventory each year.

Tax Credits 101

Thank You!