35TH ANNIVERSARY CONFERENCE
2022 HOUSING MATTERS

35 years
HOUSING ACTION ILLINOIS

LIHTC 101: The Basics of Low-Income Housing Tax Credits

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Low Income Housing Tax Credit 101

Jolyn Heun and Billy Lyman

Housing Action Illinois Housing Matters Conference 2022

October 21, 2022

Agenda

1. Overview of LIHTC Program
2. LIHTC in Illinois
3. LIHTC Specifications and Requirements
4. Basic LIHTC Deal Structures and Roles and Responsibilities of Key Players in LIHTC deal
5. Calculating LIHTC
6. Nonprofit Involvement in LIHTC
7. Illinois COVID-19 Funds
8. Additional Funding Available for LIHTC Projects

Glossary of key LIHTC terms included as appendix.

Poll: Which of the below best describes the role your organization plays in the affordable housing industry?

For-profit Developer?

Nonprofit Developer?

Government/Agency?

Supportive Services Provider?

For-profit Lender?

Tax Credit Investor?

Accountant?

Other?

Poll: In which area of the state do you primarily work?

Southern Illinois (South of I-70)?

Chicago Metro?

St. Louis Metro?

Central Illinois?

(N of I-70, S of I-80/Will County, areas E of and incl. Peoria & Springfield)

Western Illinois/Forgottonia?

(N of I-70, S of I-80, W of Peoria & Springfield)

Other?

#18

Northwestern Illinois?

(N of I-80, W of Chicago Metro)

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What can YOU tell US about LIHTC?

What can WE tell YOU about LIHTC?

Overview of LIHTC

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Overview of LIHTC Program

- Subsidizes cost of providing housing to people whose income is at or below 60-80% of the area median income (“AMI”)
- Indirect subsidy encourages public/private partnerships
- Credits available to Owner over 10-year credit period
- 15 year recapture period / min. 30-year extended use period
- Benefits
  - Affordable housing for tenants (income restricted and rent restricted)
  - Tax credit equity reduces amount of debt needed to finance development
  - Reduced debt allows for project to support debt service at restricted rents
  - Investor gets tax benefits and/or CRA benefits

Why are Tax Credits so valuable and impactful?

Tax Deduction

$20

Reduces income used to calculate tax due

VS

$20

Tax Credit

Directly reduces tax due

Gross income (before tax) = $100
Tax rate = 50%

With Tax Deduction, tax due = $40

(100-20)*.5 = $40

With Tax Credit, tax due = $30

100*.5 - 20 = $30

Tax credits are dollar-for-dollar reductions of tax due, MUCH GREATER IMPACT

LIHTC in Illinois

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Types of Credits

9% Credits (Federal Tax Credit)

- Illinois and each state receives a limited amount of 9% credits annually to allocate to projects
- For new construction and rehab costs only

4% Credits (Federal Tax Credit)

- As-of-right credits based on the project being financed with tax-exempt bonds

Acquisition Credits (Federal Tax Credit)

- May be earned in both 9% and 4% deals for the costs of acquiring an existing structure
- Credits calculated at the 4% credit rate

Administering Agencies in Illinois

Illinois Housing Development Authority (IHDA)

- Annual Qualified Allocation Plan (“QAP”) (2022-2023)
- Preliminary Project Assessment (PPA)
- 9% LIHTC Applications accepted once per year
- 4% LIHTC Applications accepted on a rolling basis
- Bond financing, construction and permanent first mortgage loans, soft funds, and the Illinois Donation Tax Credit (officially known as the Illinois Affordable Housing Tax Credit)

Administering Agencies in Illinois

City of Chicago

- Biennial Qualified Allocation Plan (2021 awarded, 2023 next)
- Department of Housing Multifamily Financial Assistance Application
- 4% and 9% LIHTC
- Tax-exempt bond financing, construction and permanent first mortgage loans, soft funds, and the Illinois Donation Tax Credit (officially known as the Illinois Affordable Housing Tax Credit)

Administering Agencies in Illinois

<u>IHDA LIHTC</u>

Owner/Sponsor

↓

PPA then LIHTC APP

↓

LIHTC Application

↓

IHDA Board Approval

↓

Tax Credits

<u>City of Chicago LIHTC</u>

Owner/Sponsor

↓

Stage 1 Multifamily Application

↓

Stage 2 Multifamily Application

↓

Department of Housing Approval

↓

Tax Credits

Question:

What is unusual about the LIHTC Program in Illinois?

A. No minimum set-aside requirement

B. 9% credits are allocated on a rolling basis

C. The City of Chicago can allocate LIHTC

Key Takeaways

- **Illinois Credit Agencies:** IHDA and City of Chicago
- **Credit Period:** 10 years
- **Compliance Period:** 15 years (recapture applies)
- **Extended Use Period:** min 30 years (Extended Use Agreement applies)
- **Restrictions:** Income restricted and rent restricted

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LIHTC Specifics and Requirements

9% Credits – Things to Know

IHDA Conditional Reservation Letter: reserves the LIHTC for the Project and requires payment of the non refundable reservation fee

Carryover Allocations are the typical method in which 9% credits are allocated

Timing – must be issued in the year of the credits that are being allocated (if 2022 credits are being used, then the Carryover Allocation must be issued during the 2022 calendar year)

- NOT before or after the calendar year of the credits

10% Test – Project must spend at least 10% of the project land and building costs within one year of the Carryover (Code requirement)

- 10% Certification – must send an accountant's report to the Credit Agency (IHDA) certifying that the 10% requirement was met

Placement in Service Deadline – Project must be placed in service by the end of the 2nd calendar year after the Carryover Allocation is issued

IMPORTANT:

10% Test Deadlines

IHDA may have earlier deadlines than the Code for the 10% Test.

Be sure to check your reservation letter, carryover allocation, and/or QAP for the credit agency's 10% Test deadline requirements.

IRS extending certain LIHTC deadlines due to COVID and labor and supply chain disruptions
(Notices 2022-52, 2022-05 and 2021-12)

4% Credits – New Construction and Rehab

Projects are eligible for 4% credits "as-of-right" provided that:

Tax-Exempt Bond Financing – Project must be financed with tax-exempt obligations subject to the State's volume cap

- 50% Test: **at least 50%** of the Project **must be** financed with tax-exempt obligations for credits to be claimed on **100%** of its eligible basis; if less than 50%, Project can only claim credits on the **portion** of eligible basis financed with tax-exempt obligations

- 95/5 Requirement: **at least 95%** of the bond proceeds must be used to pay for "good costs"

QAP Requirements – Project must meet Credit Agency's QAP requirements (the "42(m)(1) determination")

Financial Feasibility – Project cannot receive more credits than the Issuer determines is necessary for the financial feasibility of the Project (the "42(m)(2) determination")

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Acquisition Credits (4% Credits)

- 4% credits are also available for the costs of acquiring an existing building provided that certain rules are met including
- Only 4% credits may be taken on acquisition costs (even if 9% credits are taken on rehab costs)
- No basis boost allowed on acquisition costs
- For 9% allocations and tax-exempt bond issuances after December 31, 2020, the acquisition credit rate is fixed at 4%.

Acquisition Credits are Tricky!

Acquisition Credits contain many traps for the unwary! In particular, there are very specific rules around the prior ownership of the building throughout its life and around transfers of the building within the last 10 years

Always talk with tax counsel before transferring ownership of an existing building – or ownership interests in an existing building – if you intend to later claim acquisition for that building.

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Federal LIHTC Requirements

LIHTC is available only for a **Qualified Low-Income Building**

- Occupied by qualified low-income occupants
- Rent restricted
- One of 3 minimum set-aside requirements must be continuously complied with for the full 15-year compliance period (failure = no credits/recapture event)
- Building must be subject to an extended low income housing commitment of at least 30 years by the end of the taxable year in which any LIHTC are to be taken
- Low-income tenants may not be evicted (other than for cause) and rents may not be increased for 3 years after termination of extended use period

Federal LIHTC Requirements

One of the Minimum Set-Aside Requirements must be met:

- **40/60 Test** - at least 40% of the residential rental units must be both rent restricted and occupied by individuals whose income is 60% or less of AMI
- **20/50 Test** - at least 20% of the residential rental units must be both rent restricted and occupied by individuals whose income is 50% or less AMI
- **Income Averaging** - at least 40% of the residential units must be both rent restricted and occupied such that the **average income** for the LIHTC units does not exceed 60% (no LIHTC units can exceed 80% AMI) [New IA regulations/fixes released on 10/7/22]

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Question:

Which of these is a minimum set-aside requirement?

A. The 95/5 test
B. The 40/60 test
C. Income Averaging
D. Both B and C

Question:

What is one way that the 4% LIHTC differs from the 9% LIHTC?

A. Can be claimed for new construction or rehab projects

B. Projects are eligible “as-of-right”

C. Projects must have extended use agreements

D. LIHTCs awarded pursuant to QAP

Key Takeaways: Federal LIHTC

- All projects must satisfy a **minimum set-aside** test:
  - 40/60 Test (or 25/60 in NYC)
  - 20/50 Test
  - Income Averaging
- **9% LIHTC:**
  - Allocated by Credit Agency in competitive process
  - 10% Test applies
  - PIS deadline
- **4% LIHTC:**
  - Awarded “as-of-right” based on:
    - Qualifying tax-exempt bonds
    - Threshold QAP requirements met (42(m)(1) determination)
    - Financial feasibility (42(m)(2) determination)
  - 50% Test applies
- **Acquisition Credits:** 4% rate every time (even in a 9% deal)

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Basic LIHTC Deal Structures

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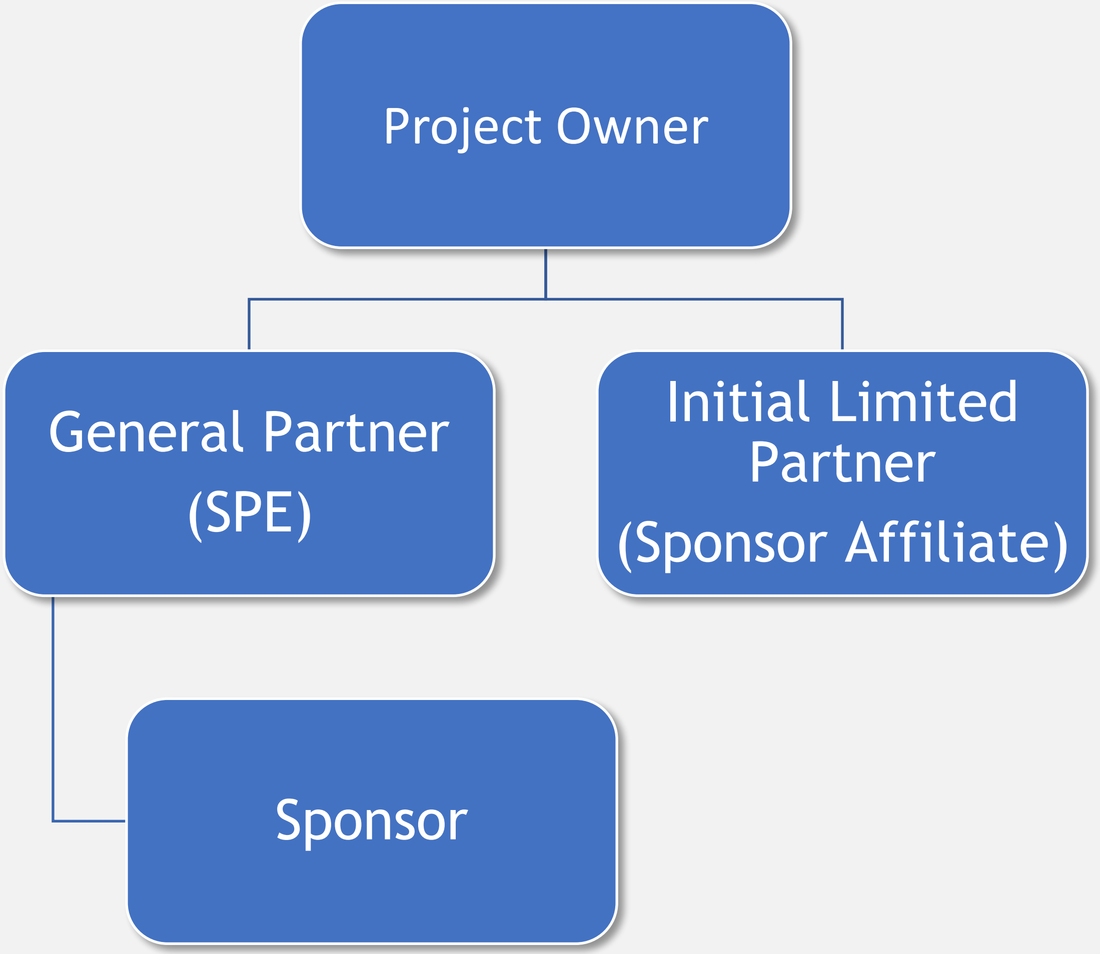
Basic LIHTC Deal Structures

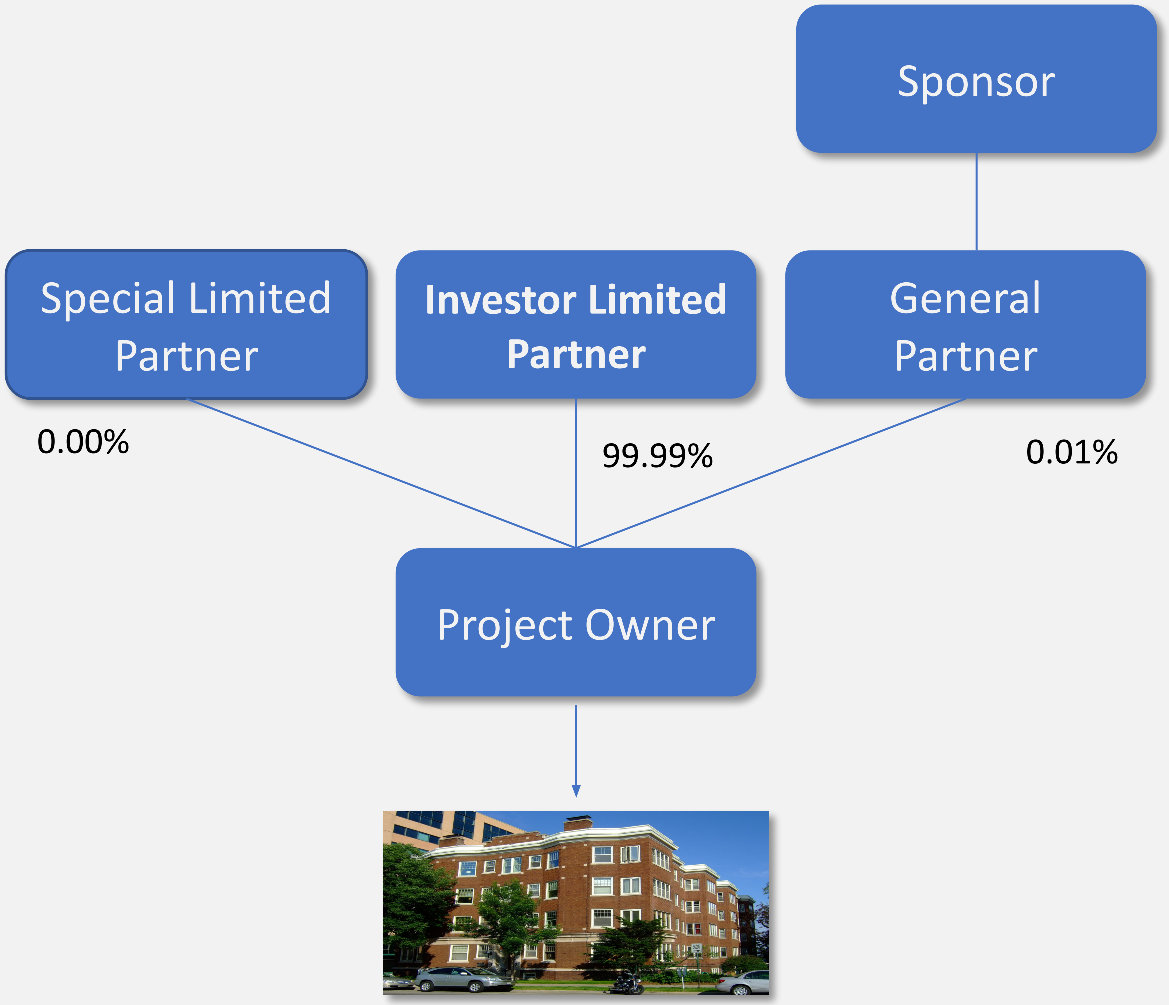
1. Financing Applications/Equity RFPs
2. Owner Organizational Structure
3. GP Rights and Responsibilities
4. Sponsor Rights and Responsibilities
5. Developer Rights and Responsibilities
6. Tax Credit Investor Rights and Responsibilities
7. Entire Deal Structure

The Project Owner Pre-Closing



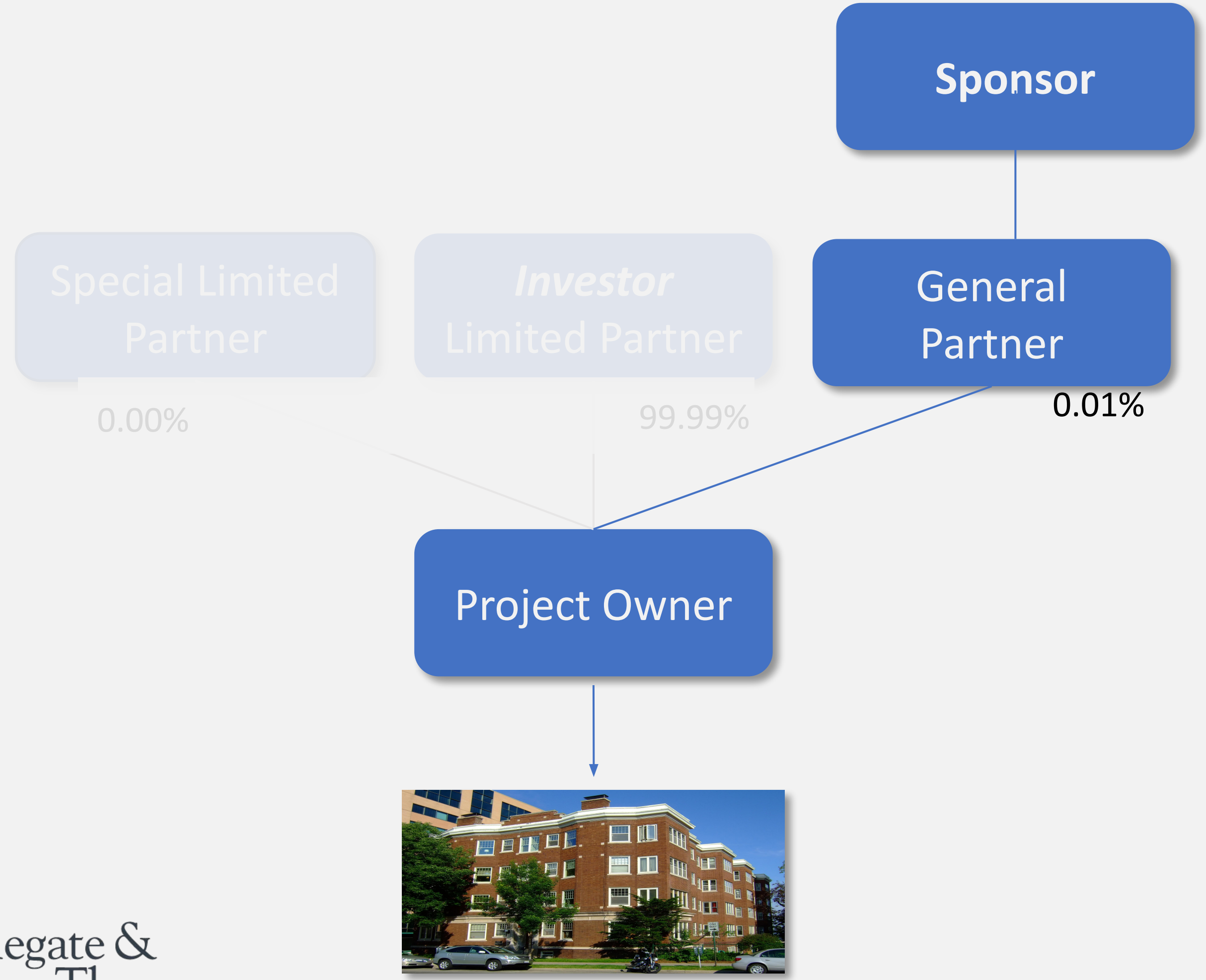
The Sponsor will form special-purpose entities to serve as the Project Owner and General Partner/Managing Member and will put in place an Initial Limited Partner

Basic LIHTC Deal Structure: Closing Ownership



At initial closing, the initial limited partner withdraws and the Investor Limited Partner is admitted pursuant to an **Amended and Restated Limited Partnership Agreement** (LPA) that sets forth each party's rights and obligations

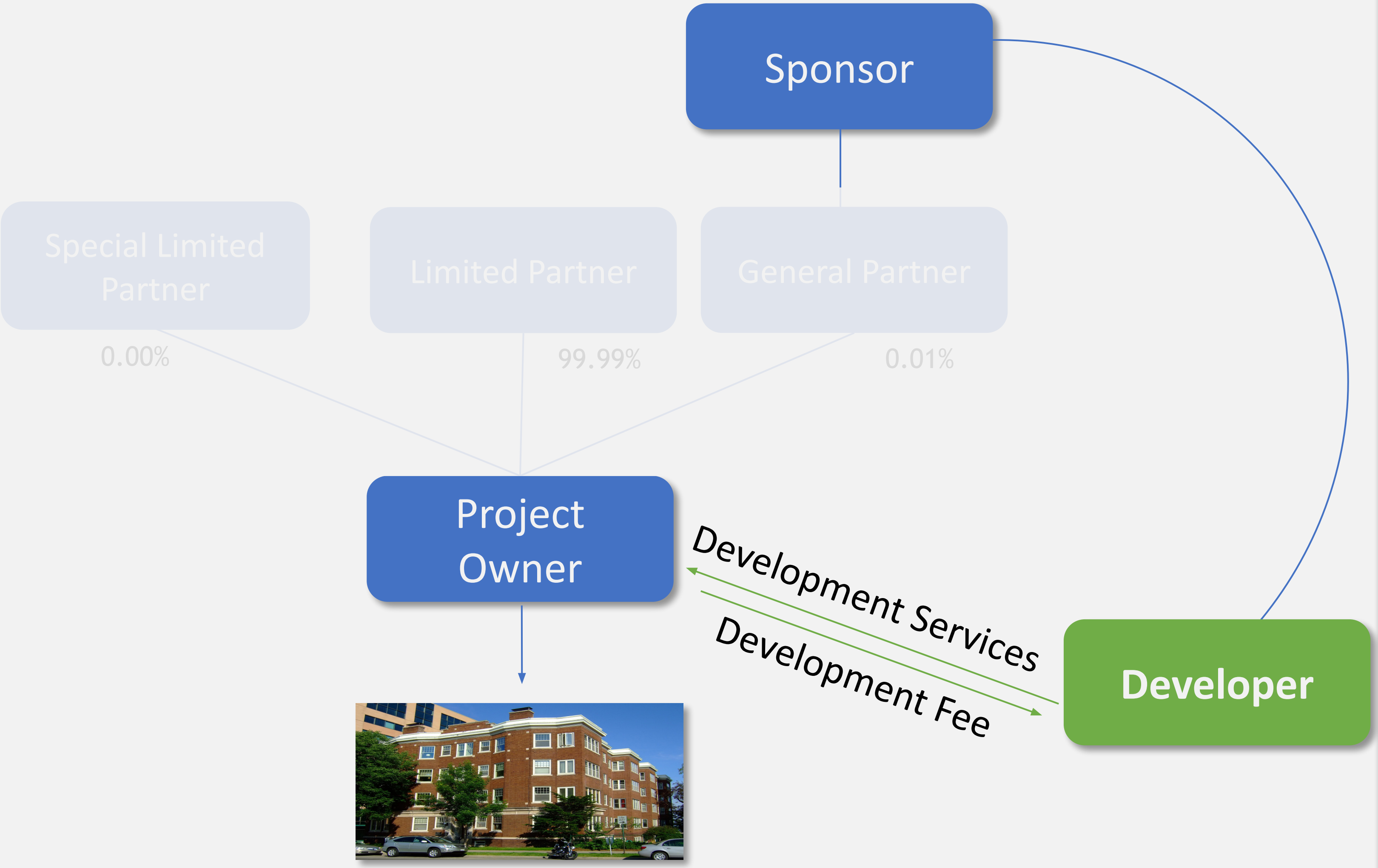
Basic LIHTC Deal Structure: Sponsor



Sponsor Rights and Obligations

- Controls GP and typically also Developer
- Guarantees all GP and Developer obligations, including:
  - Construction Completion Guaranty
  - Operating Deficit Guaranty
  - Tax Credit Guaranty
  - Environmental Indemnity
- May receive purchase option at end of compliance period in lieu of GP
- If an NFP, also may receive a Section 42 (below market) right of first refusal to purchase the project at the end of compliance period

Basic LIHTC Deal Structure: Developer



Developer Rights and Obligations

- Constructs/rehabilitates the Project at the direction of Project Owner and GP
- Obligated pursuant to the **Development Agreement** with Project Owner
- Receives Developer Fee ($$$$) in exchange for its services
- Deferred Developer Fee can be a financing source but must be paid off by Year 15 to be included in eligible basis
- Typically a subsidiary of the Sponsor and an affiliate of the GP (but not always)

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Basic LIHTC Deal Structure: Equity RFPs

Investor

RFP

LOI

Sponsor

Limited Partner

Equity Investment
$$$$$$$$$$$$$$$

99.99% interest
99.99% of the Tax Credits
99.99% of the Tax Deductions

Project Owner

With tax credits allocation and other sources, Sponsor finds a LIHTC investor who will provide capital to Project in return for an interest in the project entity that will deliver tax credits and tax deductions to the investor entity

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Why do investors invest?

- Tax Credits
- Tax Deductions
- Community Reinvestment Act (CRA) Credits (in some cases)

The tax credit investor is paying $0.XX per credit today for a future stream of tax credits and tax deductions over a 10-year credit period and tax deductions over the 15-year compliance period (the projected term of investment)

Equity Considerations

- Amount of projected credits
- Amount of projected deductions (interest on project loans, depreciation, fees)
- Timing of credit delivery and deductions (lease-up schedule, bonus depreciation, tax-exempt use property, simple vs. compounding interest, cash vs. accrual basis fee recipients)

Basic LIHTC Deal Structure: Tax Credit Investor

Tax Credit Investor Obligations

- Contributes equity (makes capital contributions) to the Project Owner as development benchmarks are achieved (e.g. closing, completion, conversion, 8609)
- No liability for debts and obligations of the Project Owner

99.99%

0.00%

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Basic LIHTC Deal Structure: Tax Credit Investor

Tax Credit Investor Rights

- Consent rights over material decisions (including new debt and debt sizing)
- GP Removal Right
- Repurchase Right
- Beneficiary of Guaranties:
  - Construction Completion
  - Operating Deficit
  - Tax Credit
  - Environmental Indemnity
- Typically receives 10% of residual cash flow and capital transaction proceeds
- Primary return is tax credits and deductions
- May use special limited partner for asset management, consent and enforcement rights

99.99%

0.00%

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Question:

What is a right or obligation of a NFP sponsor that is not a right or obligation of a for-profit sponsor?

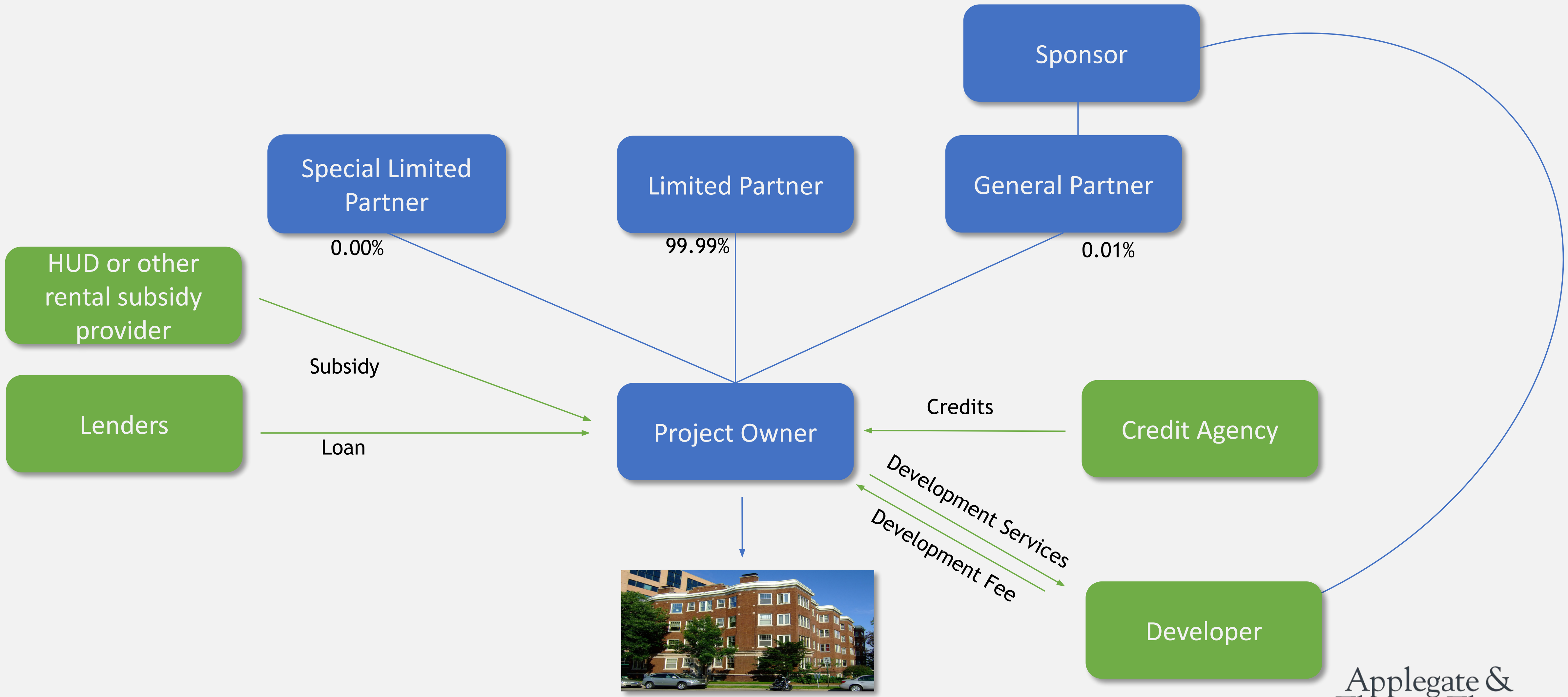
A. Control the General Partner/Managing Member

B. Provide guaranties and indemnities

C. Receive purchase options

D. Receive a Section 42 below-market right of first refusal

Basic LIHTC Deal Structure: Entirety



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Key Takeaways

Primary Roles:

- **GP/MM:** oversees development and operation of project
- **Developer:** engaged by Project Owner to oversee and coordinate development of Project
- **Sponsor:** guarantees obligations of GP/MM and Developer for the benefit of Tax Credit Investor (and oftentimes lenders)
- **Tax Credit Investor:** contributes equity as certain development and operational benchmarks are met
- **Upper Tier Investors:** contribute equity to Tax Credit Investor as certain development and operational benchmarks are met

Calculating LIHTC

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Calculating Federal LIHTC

What is Basis?

IRS valuation of an asset (land, building, driveway, refrigerator) for tax purposes

Key concepts for LIHTC calculations are **eligible basis** and **qualified basis**

Eligible Basis – What counts?

New Construction:

- Hard and soft construction costs, including Developer Fee
- Note there are exclusions and exceptions – e.g., off-site work

Rehabilitation:

- Hard and soft construction costs, including Developer Fee
- Minimum rehab costs - $7,100 per unit or 20% of acquisition costs

- Acquired Building
  - Cost of purchasing the building, not land
  - Only eligible for 4% credit on cost of building
  - Must also be receiving credits for rehab of building in order to qualify

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Eligible Basis – What counts?

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ALWAYS ELIGIBLE BASIS	SOMETMES ELIGIBLE BASIS	NEVER ELIGIBLE BASIS
Direct Costs - Direct material and labor costs from constructing/rehabbing Project	Indirect Costs - "All costs other than direct material costs and direct labor costs . . . . Indirect costs are properly allocable to property [constructed/rehabbed] . . . when the costs directly benefit or are incurred by reason of . . ." constructing/rehabbing Project	All other costs not directly benefitting or incurred by reason of constructing/rehabbing Project
e.g., hard construction costs paid to contractor, architect fees, engineering fees, building permits, impact fees, environmental remediation, utility tap fees, developer fees	e.g., legal fees related to const/rehab of building (not acquisition of land), insurance during construction, taxes, fees, and costs paid during construction/rehabilitation period	e.g., marketing costs, syndication costs, loan fees, reserves, IHDA LIHTC application and assessment fees (10% of credit award), land acquisition fees and service fees related to land acquisition (attorney fees, recording fees, etc.), letter of credit or P&P bond fees, taxes, fees, and costs paid outside of construction/rehabilitation period

Eligible Basis – Basis Boost

Eligible Basis for new construction or rehabilitation costs can be increased by 30% based on:

- **Qualified Census Tract ("QCT")** – high poverty area
- **Difficult Development Area ("DDA")** – high cost area
  - QCTs and DDAs are determined by HUD annually
- **IHDA Discretion ("Discretionary Boost")** – determination that increase in credits is needed for the financial feasibility of the Project (9% LIHTC only)
  - Must be a project-specific determination

QCT and DDA Designations

HUD updates its QCT and DDA designations annually. A project can be in a QCT or DDA at the time of the application but fall out of the QCT or DDA by the time the carryover allocation or bonds are issued.

Always check your project's QCT/DDA status each year!

There are special rules that allow for a project to maintain its basis boost after falling out of a QCT or DDA if certain requirements are met.

Qualified Basis

- **Applicable Fraction:** portion of project that is low-income
- Lesser of:
  - **Unit Fraction** (low-income units / total residential units)
  - **Floor Space Fraction** (low-income unit floor space / total residential unit floor space)
- Eligible Basis x Applicable Fraction = **Qualified Basis**

Example: 9% Tax Credit Calculation

Eligible Basis – Pre-boost	$10,000,000
Basis Boost Basis increased if building is in "qualified census tract" or "difficult development area" or designated as needing a boost	130%
Eligible Basis – Post-boost	**$13,000,000**
Applicable Fraction Lesser of the Unit Fraction (low-income units / total residential units) or Floor Space Fraction (low-income unit floor space / total residential unit floor space)	100%
Qualified Basis Based on proportion of property used for affordable housing. Used to generate LIHTC credits	**$13,000,000**
Applicable Percentage	9%
Annual Tax Credits ($13,000,000 * 0.09%)	**$1,170,000**
Credit Period	10 years
Aggregate Tax Credits (Annual Tax Credits * Credit Period)	**$11,700,000**
Price Per Credit Value of the credit today	$0.95
Investor Equity ($11,700,000 * $0.95) Equity an investor contributes in exchange for the 9% tax credit	**$11,115,000**

Example: 4% Tax Credit Calculation

Eligible Basis – Pre-boost	$10,000,000
Basis Boost Basis increased if building is in “qualified census tract” or “difficult development area” or designated as needing a boost	130%
Eligible Basis – Post-boost	**$13,000,000**
Applicable Fraction Lesser of the Unit Fraction (low-income units / total residential units) or Floor Space Fraction (low-income unit floor space / total residential unit floor space)	100%
Qualified Basis Based on proportion of property used for affordable housing. Used to generate LIHTC credits	**$13,000,000**
Applicable Percentage	4%
Annual Tax Credits ($13,000,000 * 0.04%)	**$520,000**
Credit Period	10 years
Aggregate Tax Credits (Annual Tax Credits * Credit Period)	**$5,200,000**
Price Per Credit Value of the credit today	$0.95
Investor Equity ($5,200,000 * $0.95) Equity an investor contributes in exchange for the 4% tax credit	**$4,940,000**

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Key Takeaways

- **Eligible basis**
  - Certain items may be excluded under LIHTC rules (e.g. costs funded with TE proceeds, certain financing fees, etc.)
  - May qualify for a **basis boost** (up to 130%)
- **Qualified basis**
  - Percentage of project that is low-income; lesser of:
    - Unit Fraction (percentage of low-income units)
    - Floor Space Fraction (percentage of floor space dedicated to low-income units)

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Considerations for NFP Involvement

NFP Involvement Topics

1. What is a not-for-profit in the LIHTC context?
2. How can NFPs use LIHTC to support their mission?
3. What are things NFPs should look out for when getting involved in LIHTC project?

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What is an NFP?

"Qualified Nonprofit Organization"

- §501(c)(3) or 501(c)(4) organization
- not affiliated with or controlled by a for-profit organization
- Bylaws or Articles include fostering low-income housing as an exempt purpose

What is an NFP?

“Qualified Nonprofit Organization”

- NFP’s interest in General Partner/ Managing Member can be owned directly or through a wholly-owned subsidiary (corporation or LLC)

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Why Should NFPs Get Involved in LIHTC?

- Credit agencies provide incentives for NFP involvement:
  - IHDA QAP (2022-2023) gives 3 points
  - City of Chicago reduces application fee by 50%
- Compete in Section 42 non-profit set-aside
  - At least 10% of IHDA’s annual credit pool is set aside solely for NFPs
  - If NFPs not applying to use those credits, they go unused since earmarked for NFP

In order to compete for additional NFP Set-Aside Credit Pool, project must meet following requirements:

- NFP maintains majority interest in GP/MM (through Compliance Period)
- Section 42 Below-Market ROFR in favor of NFP
- “Material Participation” by NFP in project

Per Section 42 . . .

Material Participation

An NFP must be regularly, continuously and substantially involved in providing services integral to development and operation of the project

Guidelines for Material Participation

- NFP is the sole or managing GP/Member
- NFP is involved in actual development and operations, not just providing consent
- NFP is participating throughout the year, not just periodically

Okay, but I'm still not convinced . . .

Why ELSE should an NFP get involved in a LIHTC project?

NFPs qualify for more favorable financing:

- IHDA COVID-19 Grants
- Illinois Donation Tax Credit
- Advantageous structuring of TIF, AHP, other grants, etc.
- Possible Property Tax Exemption/Abatement
- Possible Real Estate Transfer Tax Exemption/Reduction

Okay, but I'm still not convinced . . .

Why ELSE should an NFP get involved in a LIHTC project?

LIHTC designed specifically with NFP-participation in mind

- Various ways code incentivizes NFP participation in projects (e.g., extra scoring on application, set-aside funds)
- Another potential arrow in quiver for NFP to meet its mission
- If NFPs not using them, not only will 10% of credits go unused but also less scrupulous and less-mission-oriented actors will use them

Okay, but I'm still not convinced . . .

Why ELSE should an NFP get involved in a LIHTC project?

LIHTC is not a perfect solution to our current housing crisis, but—in lieu of a more effective policy solution— it is the best source of immediately available funds to add affordable units to the housing supply

- **Better yet,** they are already allocated by the **Federal Government** and, unlike grants or other soft funding, are not subject to political whims and winds or Congressional budgetary battles

Sounds great! Where do I sign?!?!

Be mindful of the following:

- NPFs can trigger "tax-exempt use" rules
  - Proper structuring can address potential issues – talk to your attorney!
- Any Guarantees that NFP might be obligated to cover on behalf of GP/MM or in event NFP is Developer:
  - Construction Completion Guaranty (excess construction costs)
  - Operating Deficit Guaranty (excess operating costs)
  - Tax Credit Guaranty (remuneration of Investor of any TC shortfall)
  - Environmental Indemnity
- Liability for breach of project agreements (equity agrmts, loan agrmts, subsidy agrmts)
- Events triggering Tax Credit recapture or Investor repurchase
- LIHTC Development size and cost considerations (# of units)

Question:

What is <u>not</u> a way to demonstrate material participation by an NFP?

A. Section 42 Right of First Refusal

B. Social or support services by NFP

C. NFP has consent rights only

D. NFP has 100% interest in General Partner or Managing Member

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Key Takeaways

- NFPs can bring credit and financing advantages to LIHTC projects
- NFPs must meet certain requirements to qualify for these advantages
- NFPs may be required to guaranty certain obligations
- NFP involvement can create tax issues that require proper structuring

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COVID-19 Funds in Illinois

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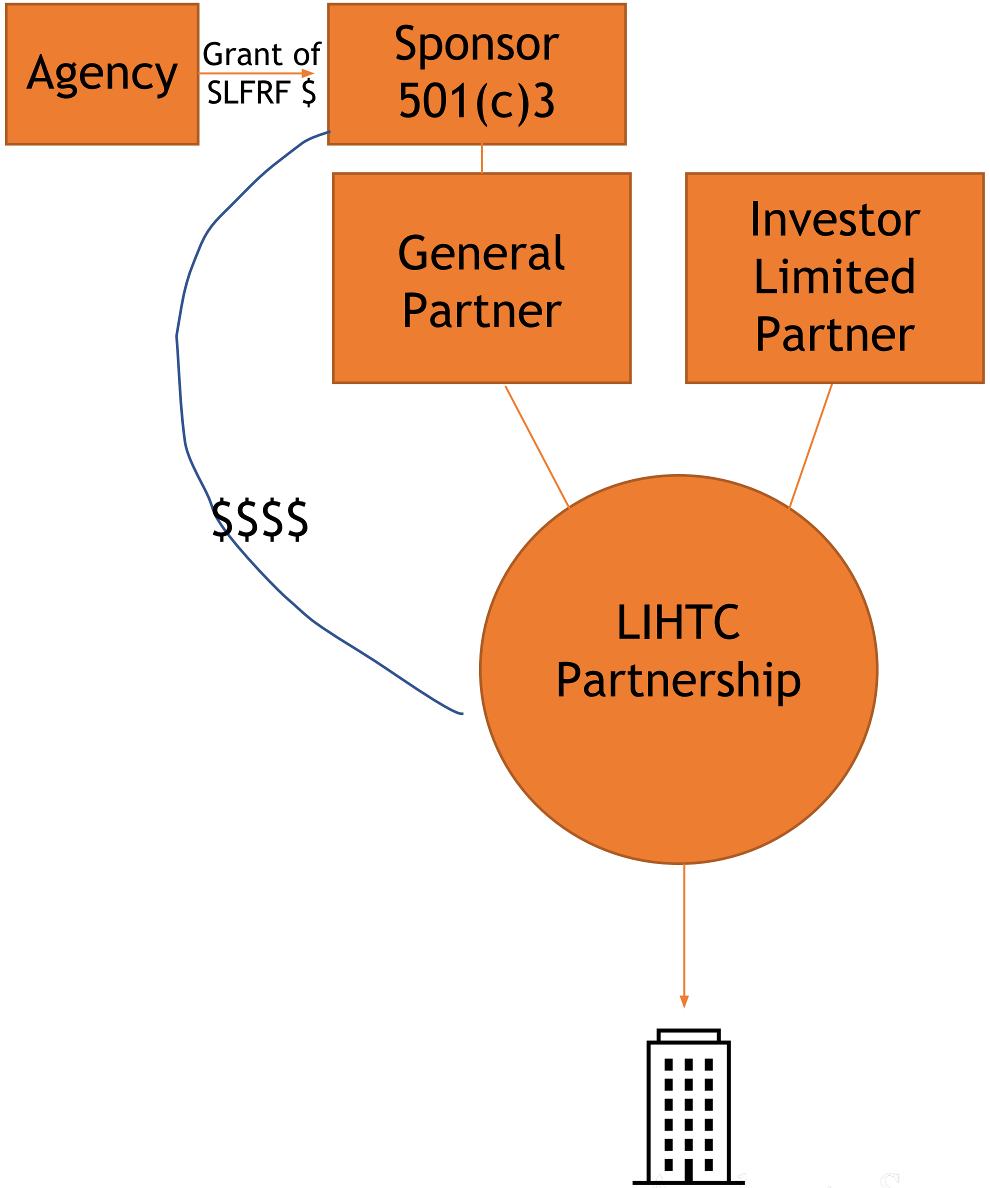
COVID-19 Affordable Housing Grant Program

- Funded by the American Rescue Plan Act (“ARPA”) and administered by IHDA
- Qualified Development = qualified low-income housing project that received LIHTC
- Prioritize Developments:
  - Disproportionately affected by COVID-19 based on number of positive cases
  - Contracts with certified disadvantaged business enterprises and underrepresented businesses owned by minorities, women, veterans, LGBTQIA and persons with disabilities
  - Project Labor Agreements with local building trades
  - Contracts or Subcontracts with a registered apprenticeship program

Grant Structure

- IHDA Grant to NFP that is part of the ownership structure
- Maximum Grant amount: 35% Total Development Costs
- NFP enters into Grant Agreement with IHDA
- NFP can loan the funds to the LIHTC owner as a Sponsor Loan
- Regulatory Agreement (NFP, LIHTC Owner and IHDA) recorded against the Development
  - LIHTC Affordability Restrictions
  - 15 year compliance period
  - Recapture



Additional Funding to Consider

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Additional Funding to Consider

- Property Tax Exemption/Abatement
- Real Estate Transfer Tax Exemptions/Reduction
- Soft/Gap Funding
  - AHP/FHLB
  - IHDA Soft Loans (including IAHTF Funds)
  - Local (Municipal/Township/County) Loans
- Pairing with Other Tax Credits
  - Historic Tax Credits (both Federal and State available)
  - New Markets Tax Credits
  - Energy Tax Credits and Rebates
- Rental Subsidies

Thanks, HAI!!

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A Donation Generates a Tax Credit

- A $0.50 transferable tax credit for each $1.00 donation to a **nonprofit Sponsor**
  - Donation: land, cash, materials, personal property (NOT services) to **NFP** for affordable housing
  - Tax Credit applies to Illinois State Income Tax
  - Issued by IHDA or City of Chicago
  - The Tax Credit is TRANSFERABLE; the donor can:
    1. Keep the credits
    2. Transfer to sponsor/project owner
    3. Transfer to another entity, i.e., a tax credit investor

DTC Project Requirements

Purpose: Build/Preserve Affordable Housing

- At least 25% of units at 60% AMI
- 100% of owner-occupied units at 120% AMI
- Rents at 30% of imputed income

Key Takeaways: State DTC

- If an Illinois LIHTC deal involves an NFP or CDC, consider the Illinois Affordable Housing Tax Credit or “Donation Tax Credit”
- The Sponsor must materially participate for 10 years
- Land donations are common and have certain valuation considerations
- Can be a significant financing source
- Income restricted and rent restricted

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Questions?

Glossary

1. AMI – shorthand for "area median gross income" and is used as the basis for determining income limits under Section 42 of the Code. Area median gross income is determined and published annually by HUD consistent with determinations of area median gross income under Section 8 of the Housing Act of 1937 and including adjustments for family size.
2. Applicable Fraction – the portion of the LIHTC project that is reserved for low-income tenants, more particularly defined as the lesser of the unit fraction (number of low-income units over total residential units) and the floor space fraction (low-income units square footage over the total residential floor space of the building).
3. Code – the Internal Revenue Code of 1986, as amended.
4. CRA – the Community Reinvestment Act, enacted by Congress in 1977. The CRA requires, among other things, that certain banks and financial institutions reinvest in the communities in which they do business, including low and moderate income neighborhoods.
5. Credit Agency – the “housing credit agency” within a State authorized to allocate LIHTC. In Illinois, the entities authorized to act as Credit Agencies are IHDA and the City of Chicago.
6. Credit Period – the 10-year period over which the LIHTC is claimed for each building in a LIHTC project, which may be extended to 11 years if credits that are not allowed in the first year are deferred to an 11^{th} year.
7. Compliance Period – the 15 years beginning with the first year of the Credit Period during which LIHTC may be subject to recapture.

Glossary

8. Developer – the entity engaged by the Project Owner to provide development services to the LIHTC project in exchange for a development fee, all pursuant to the terms of a Development Agreement between the Developer and Project Owner.
9. Developer Fee – the fee paid to Developer for development services provided to Project Owner and LIHTC project pursuant to a Development Agreement.
10. Difficult Development Area (DDA) – an area designated by HUD and published annually as having high construction, land, and utility costs relative to AMI.
11. DOH – in this presentation specifically, used to refer to the City of Chicago Department of Housing.
12. DTC/IAHTC – Illinois Affordable Housing Tax Credits, sometimes also referred to as “donation tax credits” due to the method in which such credits are earned.
13. Eligible Basis – generally, the adjusted basis of the building(s) as of the close of the first taxable year of the Credit Period, as provided under Section 42(d) of the Code, which generally includes the cost of acquiring a qualified existing building, construction or rehabilitation costs, costs of acquiring personal property for use by the tenants, and costs of facilities, such as swimming pools and parking lots, but does not include the cost of land and expenses related to permanent financing and LIHTC syndication.
14. Extended Use Agreement (EUA) – the agreement between the Credit Agency and the Project Owner restricting the use of the LIHTC Project during the Extended Use Period (shorthand for the “extended low-income housing commitment” required under Section 42 of the Code).

Glossary

15. Extended Use Period - the period starting with the first day of the Compliance Period and ending 15 years after the close of the Compliance Period, or such later date as specified by the Credit Agency , during which the LIHTC Project must remain income and rent-restricted pursuant to the Extended Use Agreement.
16. FMV – Fair Market Value.
17. GP/MM – General Partner or Managing Member (of Project Owner).
18. HAP – in this presentation specifically, used to refer to project-based rental assistance payments (or “housing assistance payments”) under Section 8 of the Housing Act of 1937, as amended.
19. HUD – the U.S. Department of Housing and Urban Development.
20. IHDA – Illinois Housing Development Authority.
21. LIHTC – the low-income housing credit available under Section 42 of the Code, oftentimes referred to as the “federal Low Income Housing Tax Credit.”
22. LOI – Letter of Intent.
23. LP/LLC – a “limited partnership” or “limited liability company” established under State law.
24. LPA/OA – the Limited Partnership Agreement (for LPs) or Operating Agreement (for LLCs). In this presentation specifically, this term is used to refer to the document that governs the operation of the Project Owner entity, including the rights and obligations of the GP/MM and Tax Credit Investor.

Glossary

25. NFP – an entity that is exempt from federal income tax under Section 501(c)(3) or (4) of the Code, oftentimes referred to as a “not-for-profit corporation.”

26. PIS – in this presentation specifically, “placed in service” for purposes of Section 42 of the Code.

27. PPA – in this presentation specifically, Preliminary Project Assessment (prerequisite to IHDA LIHTC application).

28. Project Owner – the entity that owns the LIHTC project for federal tax purposes.

29. Qualified Allocation Plan (QAP) – the document prepared by the Credit Agency in accordance with Section 42 of the Code which, among other things, sets forth the selection criteria used to determine housing priorities of the Credit Agency in awarding LIHTC to projects.

30. Qualified Basis – under Section 42 of the Code, an amount equal to Eligible Basis multiplied by the Applicable Fraction.

31. Qualified Census Tract (QCT) – an area designated by HUD and published annually in which 50% or more of the households have income which is less than 60% of AMI for such year or which has a poverty rate of at least 25% based on the most recent year for which census data is available.

32. RFP – Request for Proposal.

33. ROFR – Right of First Refusal.

34. SPE – Special Purpose Entity.

Glossary

35. Sponsor – in this presentation and the general context of our industry, the person or parent organization that, among other things, identifies potential affordable housing sites, pursues site control and financing commitments, and applies to the Credit Agency for LIHTCs (and to the Bond Issuer for tax-exempt bonds where applicable) on behalf of the Project Owner and GP/MM. The Sponsor and/or its affiliates typically hold the controlling interest in the GP/MM and provide the key guarantees to the Tax Credit Investor and lenders in connection with the LIHTC project. The Sponsor is also oftentimes, but not always, the controlling and beneficial owner of the Developer.

36. Tax Credit Investor – in this presentation specifically, used to refer to the entity that is a limited partner or non-managing member of the Project Owner and whose primary role with respect to the LIHTC Project is to provide capital contributions to the Project Owner in exchange for receiving a projected stream of tax credits and deductions over the Compliance Period.