Understanding Tax Credits for Affordable Housing Development

Jolyn Heun & C.C. Huang

Housing Matters 2023 – Workshop I
October 19, 2023

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Thorne-Thomsen
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Jolyn Heun

Attorney at Applegate since 2019
Former senior counsel at Illinois
Housing Development Authority

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C.C. Huang

Attorney at Applegate since 2018
Former programs attorney-advisor at U.S. Department of Housing and Urban Development

How about you?

- I am a for-profit affordable housing developer
- I am a non-profit affordable housing developer
- I am a social services provider
- I am a public housing authority or other governmental body
- I am a lender or investor
- I am an advocate or policymaker
- I am a property manager
- I am an architect or general contractor
- I am an accountant or attorney

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What is your role in Illinois affordable housing?

ⓘ Start presenting to display the poll results on this slide.

How about you?

- I have used the federal low-income housing tax credit (LIHTC) to develop affordable housing
- I have not used LIHTC before

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Have you used LIHTC before?

ⓘ Start presenting to display the poll results on this slide.

How about you?

- I have used the Illinois affordable housing tax credit (IAHTC) to develop affordable housing
- I have not used IAHTC before

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Have you used IAHTC before?

ⓘ Start presenting to display the poll results on this slide.

Agenda

1. Basics of LIHTC
2. The 2024-2025 Draft IHDA QAP
3. Basics of IAHTC

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Low Income Housing Tax Credits ("LIHTC")

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The LIHTC Program

- Section 42 of the Internal Revenue Code
- Offsets federal income taxes on a dollar-for-dollar basis during 10-year credit period
- Administered by the Internal Revenue Service
- Accounts for approx. 90% of all new affordable rental housing created in the U.S.

What is a Tax Credit?

Tax Credit	Tax Deduction
$100,000 gross income	$100,000 gross income
30% tax rate = $30,000 taxes owed	$20,000 tax deduction = $80,000 adjusted income
-$20,000 tax credit	30% tax rate = $24,000 final tax liability
$10,000 final tax liability	

Basic LIHTC Owner Structure

Typically admitted at initial closing, the equity investor provides significant capital in first few years in return for annual allocation of LIHTC and other tax benefits/deductions (99.99%).

Sponsor

General Partner

0.01%

Investor Limited Partner

99.989%

Special Limited Partner

0.001%

Project Owner

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Basic LIHTC Owner Structure

NFP Sponsor

Qualified NFPs receive different treatment under Section 42 and the IHDA QAP than for-profit LIHTC applicants.

General Partner

Investor Limited Partner

Special Limited Partner

0.01%

99.989%

0.001%

NFP Sponsor controls the General Partner who controls the day-to-day operations of the Project Owner.

Project Owner

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Basic LIHTC Owner Structure

NFP Sponsor

Sponsor may also own and control the Developer who provides professional services for a fee to the Project Owner.

General Partner

Investor Limited Partner

Special Limited Partner

0.01%

99.989%

0.001%

Project Owner

Sponsor may also be or own the Property Manager of the Project and/or provide supportive services to Project tenants.

Development Services

Development Fee

Developer

Sponsor Responsibilities

- Application(s) for LIHTC and other financing or grants and subsidies
- Development of project's plan of finance and operations
- Performance of General Partner and any other affiliates involved in the LIHTC Project
- Representations, warranties, and covenants for Project
- Guaranties and indemnities to investor(s) and lender(s)

State Tax Credit Agency

Illinois Housing Development Authority (IHDA)

- Annual Qualified Allocation Plan ("QAP")
- 2024-2025 draft is out:

https://www.ihda.org/developers/qap/

- Preliminary Project Assessment (PPA) for any IHDA resource (tax credits and financing)

*City of Chicago also allocates tax credits and funds for affordable housing development

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IHDA Resources

- 9% Low Income Housing Tax Credit (federal)
- 4% Low Income Housing Tax Credit (federal) and Bond Financing
- Illinois Affordable Housing Tax Credit (state)
- First mortgage loans (permanent only or construction-to-permanent)
- Soft funds (Federal HOME and IL Housing Trust Fund among others)
- Permanent Supportive Housing Development Program

IHDA Developer Resource Center

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IHDA Application Timelines

The Illinois Housing Development Authority (IHDA) is pleased to announce tentative dates for 2024 9% Low-Income Housing Tax Credit (LIHTC) application round. Please see the key event deadlines for the 2024 9% LIHTC round below:

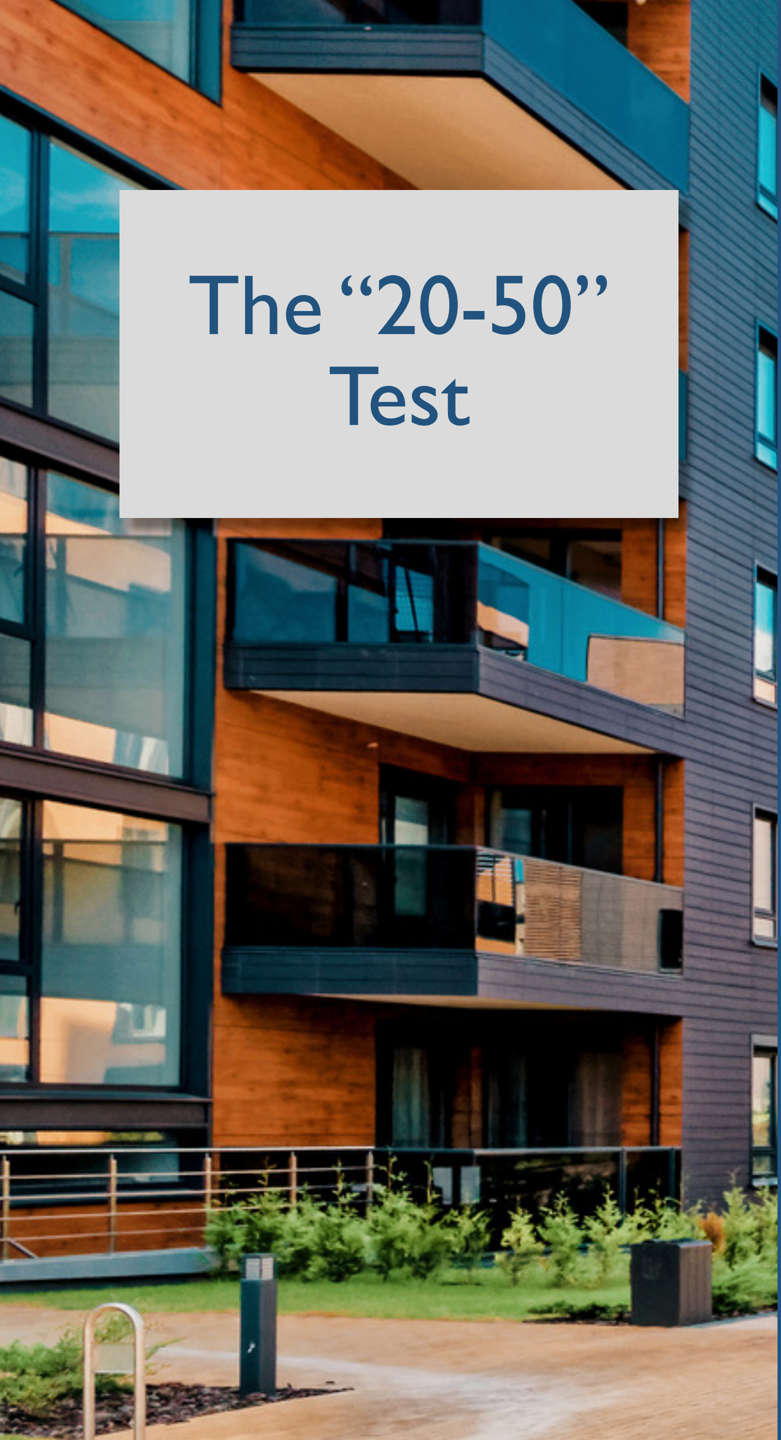
EVENT	DATE
PPA Deadline for 2024 LIHTC Applications	December 8, 2023
PPA Notification to Sponsors	February 2, 2024
2024 Applications Due	March 29, 2024
Clarification Period Notice / Responses Due	May 13, 2023 – May 17, 2024
Recommendations to Board	July 19, 2024

PPA and Application Timeline 2024 4% LIHTC

- IHDA will accept 4% LIHTC applications on a rolling basis through 2024.
- Please see the **Multifamily Transactions Timeframes** for more information on application deadlines.

LIHTC Requirements

- Minimum Set-Aside to be considered a “qualified low-income housing project” (3 options)
- Gross rent cannot exceed 30% of the imputed income limitation
- Suitable for Occupancy



The "20-50" Test

Residential Rental Property	
50% AMGI	Other
50% AMGI	Other
Other	Other
Other	Other
Other	Other

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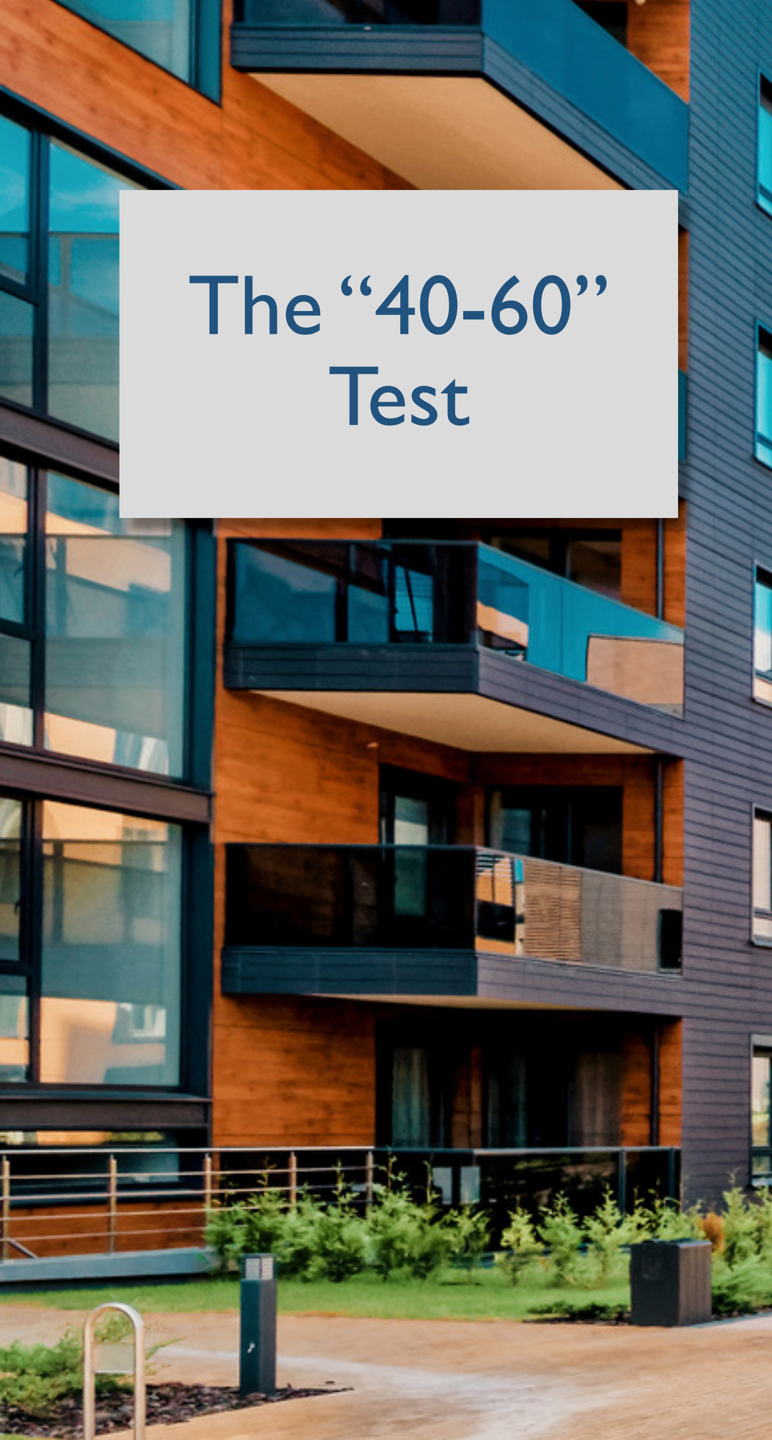

The "40-60" Test

Residential Rental Property	
60% AMGI	Other
60% AMGI	Other
60% AMGI	Other
60% AMGI	Other
Other	Other

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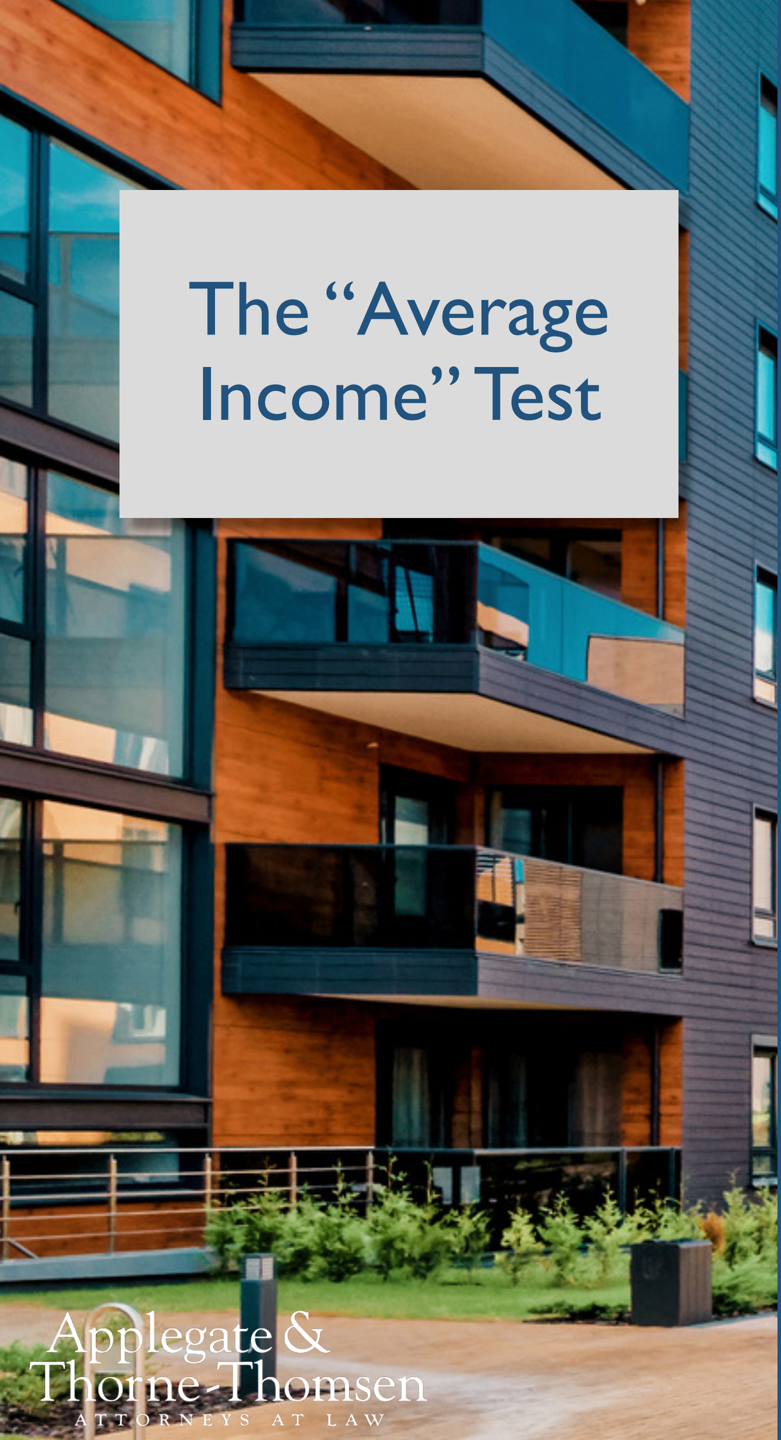
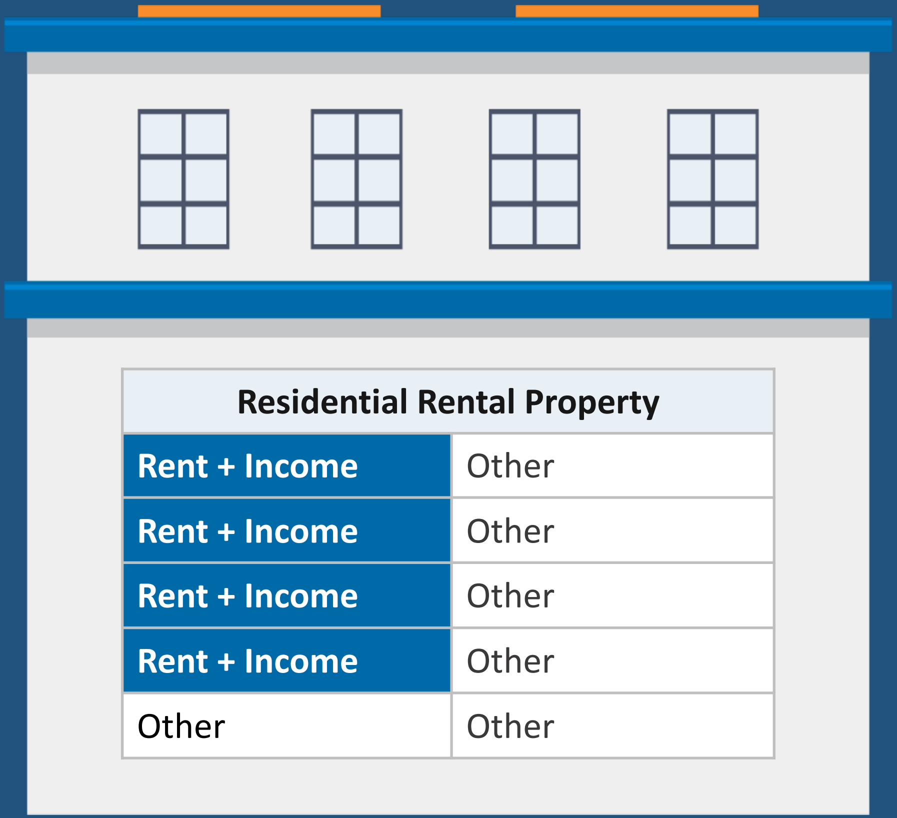
The "Average Income" Test





Residential Rental Property	
Rent + Income	Other
Rent + Income	Other
Rent + Income	Other
Rent + Income	Other
Other	Other

At least 40% (25% in New York City) of units have to be rent-restricted and occupied by households whose incomes do not exceed the designated imputed income limitations of the respective unit

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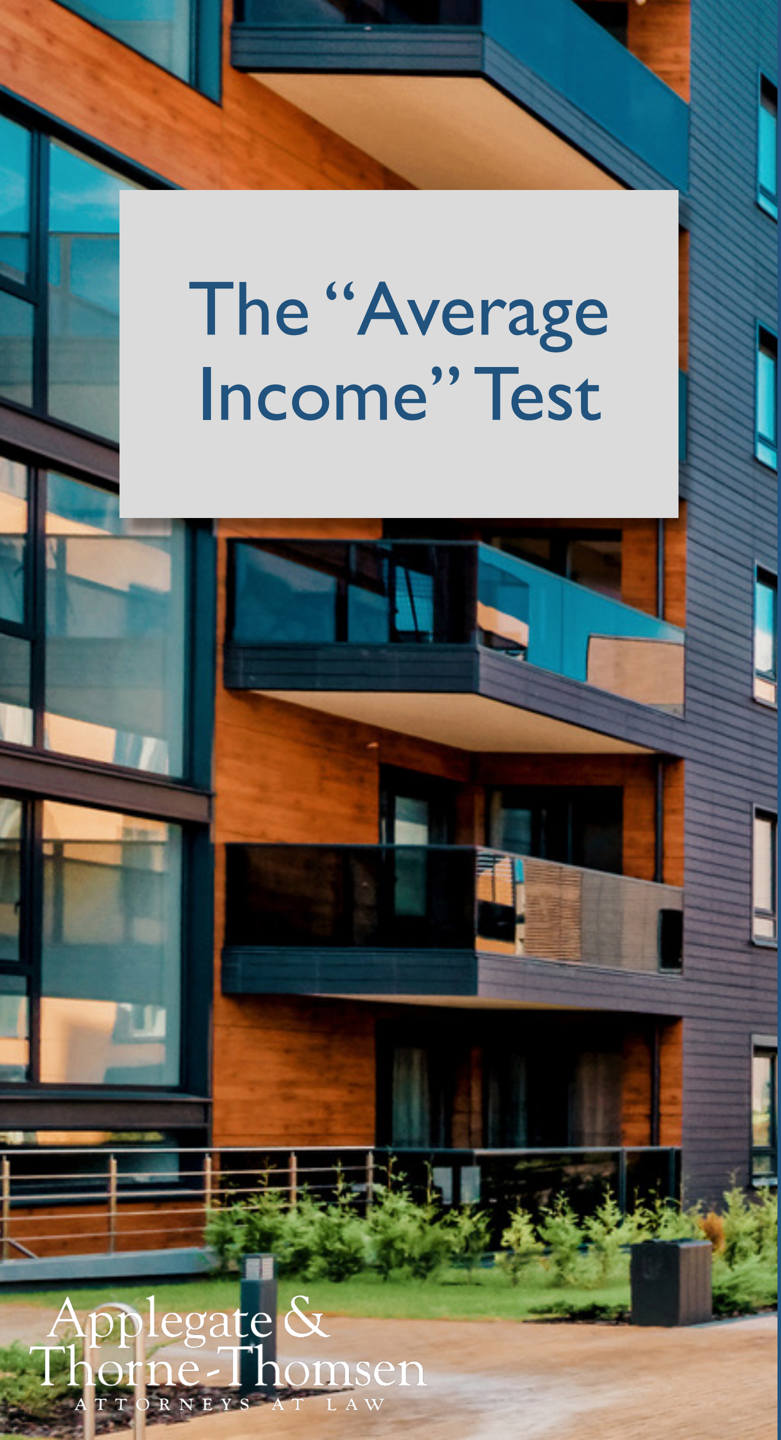
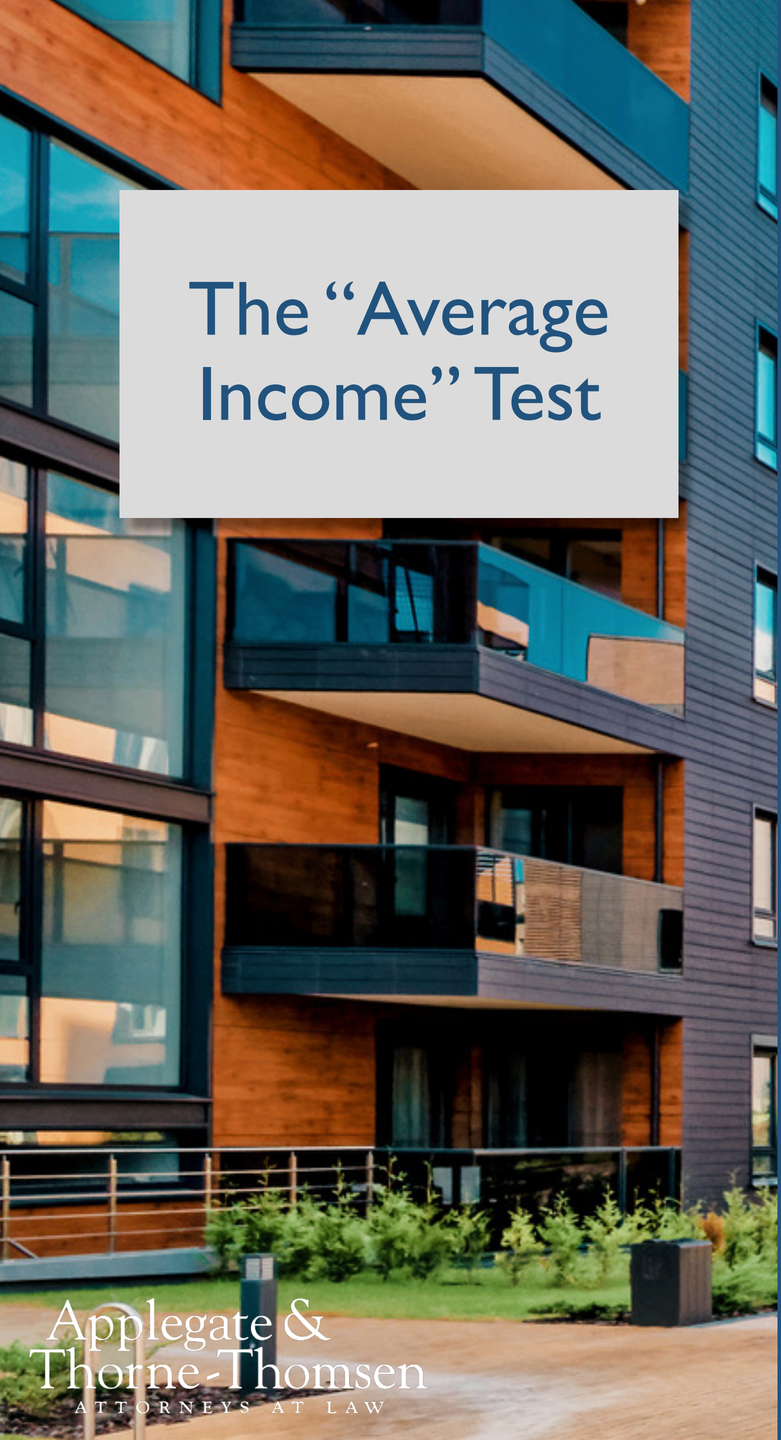
The "Average Income" Test



Residential Rental Property	
30% AMGI	70% AMGI
30% AMGI	70% AMGI
30% AMGI	70% AMGI
30% AMGI	70% AMGI
30% AMGI	70% AMGI
Average = 50% AMGI	

The average of the designated imputed income limitations cannot exceed 60% of area median gross income



The “Average Income” Test

Residential Rental Property	
60% AMGI	70% AMGI
60% AMGI	70% AMGI
60% AMGI	70% AMGI
60% AMGI	70% AMGI
60% AMGI	70% AMGI
Average = 65% AMGI	

The average of the designated imputed income limitations cannot exceed 60% of area median gross income

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One of the Minimum Set-Aside tests must be satisfied to claim <u>ANY</u> low-income housing tax credits.

Rent-Restricted Units

- “20-50” test = 30% of 50% AMGI
- “40-60” test = 30% of 60% AMGI
- “Average Income” test = 30% of the AMGI designations of each low-income unit, but the average cannot exceed 60% AMGI

Important exclusions from gross rent:

- Section 8 housing assistance payments
- Utility allowance
- Supportive service fee in rental subsidy

Suitable for Occupancy

- Used other than on a transient basis
- Determined under Treasury Regulations
- Local health, safety, and building codes

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Check-in Question

Which of the 3 basic requirements for LIHTC projects is a “cliff test”?

A. Suitability for Occupancy

B. Rent-Restricted Units

C. Minimum Set-Aside

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Which of the 3 basic requirements for LIHTC projects is a “cliff test”?

ⓘ Start presenting to display the poll results on this slide.

Other LIHTC Requirements

An extended low-income housing commitment with the tax credit agency

IHDA = LIHTC Extended Use Agreement

- Applicable Fraction
- Qualified Tenant rights
- Restriction on disposition/transfer
- Acceptance of Section 8 vouchers
- Binding on all successors
- Recorded as restrictive covenant by end of first tax credit year

IHDA requires the EUA be recorded at initial closing.

THIS INSTRUMENT WAS PREPARED BY
AND AFTER RECORDING RETURN TO:
Illinois Housing Development Authority
111 East Wacker Drive, Suite 1000
Chicago, Illinois 60601
Attention: [redacted]

Property Address: See Attached Exhibit A

Property Identification No(s): See Attached Exhibit A

[redacted]

LOW INCOME HOUSING TAX CREDIT EXTENDED USE AGREEMENT

Project Summary

Project Owner:	[redacted]
Project Owner's Address	
Project Name:	
Project Address:	
IHDA Project Application No.:	
Project Unit Count:	100/100 (Number of Low Income Units/ Total Number of Units in the Project)
Minimum Low Income Set-Aside Election:	At least 40% of the Units in the Project must be occupied by Tenants at or below 60% of Area Median Gross Income and Rent-Restricted in accordance with such income level.
Minimum Applicable Fraction for Project:	At least 100%

THIS LOW INCOME HOUSING TAX CREDIT EXTENDED USE AGREEMENT (this "Agreement") is entered into on the ___________ day of ________________, 2023, by and between ILLINOIS HOUSING DEVELOPMENT AUTHORITY (the "Authority"), a body politic and corporate established pursuant to the Illinois Housing Development Act, ILCS 3805/1 *et seq.*, as amended from time to time (the "Act") with its principal offices located at 111 East Wacker Drive, Suite 1000, Chicago, Illinois 60601, and [redacted] (the "Owner"), an Illinois limited liability company with its principal offices located at [redacted].

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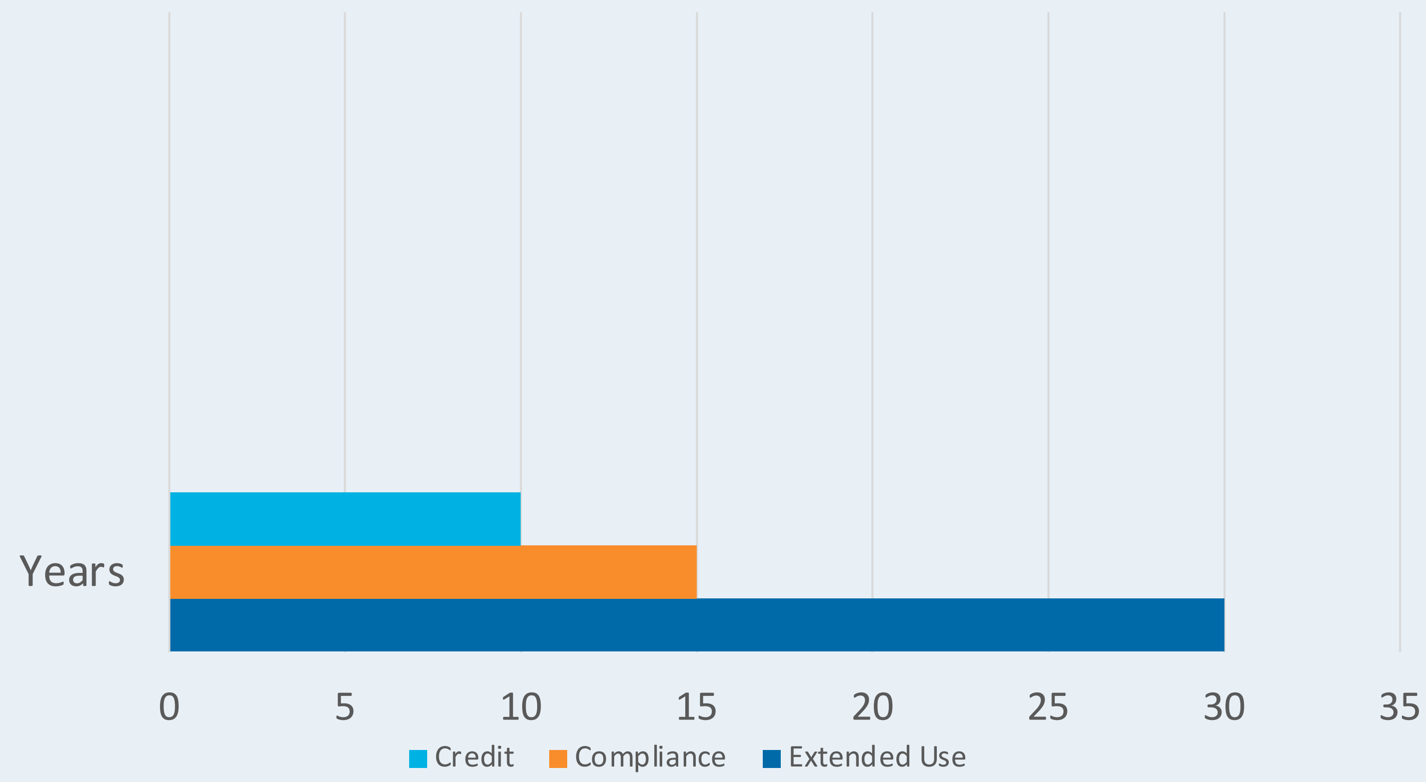
LIHTC Time Periods



Start of LIHTC

- By building
- 10 taxable years
- Placed in service (ready for occupancy) or elect to start the next tax year
- Qualified low-income building as of the end of the 1st year of the LIHTC Credit Period

Once all LIHTC requirements are met, the owner may claim LIHTC for 10 years (the Credit Period), must comply with Sec. 42 for 15 years (the Compliance Period) and provide affordable housing for 30 or more years (the Extended Use Period).

Other LIHTC Requirements

An allocation of LIHTC from the tax credit agency

- Allocation limits how much LIHTC may be claimed per year during credit period
- IRS formula for amount of LIHTC available per state
- Tax credit agency allocates based on Qualified Allocation Plan ("QAP")

The IHDA (Draft) QAP

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As an allocating agency for the Tax Credit program in Illinois, the Illinois Housing Development Authority (“Authority”) is required to publish a Qualified Allocation Plan (“QAP”) that details how it intends to award the tax credits. Pursuant to Section 42 of the Code, the QAP describes criteria the Authority considers in evaluating Projects and development teams applying for an Allocation of Tax Credits. Additionally, the QAP explains the process for obtaining Tax Credits either through the issuance of a 42(m) Letter for Projects financed through the issuance of tax-exempt bonds (“4% Tax Credits”) or through the competitive selection process (“9% Tax Credits”).

Sec. 42(m) preferences:

- Projects serving the lowest income tenants
- Projects obligated to serve qualified tenants for the longest periods
- Projects located in Qualified Census Tracts ("QCTs") and the development of which contribute to a Community Revitalization Strategy

HUD 2023 and 2024 QCTs map website

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IHDA QAP Policy Priorities:

- Statewide Equity
- Most Vulnerable Populations
- Sustainability and Energy Efficiency

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Statewide Equity

- Community Revitalization mandatory thresholds
- QCT and/or Racially or Ethnically Concentrated Area of Poverty
- Black, Indigenous, or People of Color and minority participation on development team
- Affordable housing in State’s least affordable communities
- Community revitalization planning activities in 9% LIHTC applications

Most Vulnerable Populations

- Requiring Statewide Referral Network and veterans waitlist
- Deeper income targeting
- Additional accessible units
- Special Most Vulnerable Populations scoring category for 9% LIHTC applications
- New Permanent Supportive Housing ("PSH") Track Scoring for Projects that dedicate at least 30% of total units to Supportive Housing Populations

Sustainability and Energy Efficiency

- Enterprise Green Communities ("EGC") mandatory requirements
- Green building certification
- On-site gardening facility incentive for 9% LIHTC applications

QAP Policy Priorities		
Tax Credit Type	**Requirements and Incentives**	**QAP Section to Reference**
Statewide Equity		
4%, 9%	Mandatory Community Revitalization Strategies thresholds promoting local planning efforts required for Projects in QCTs and/or R/ECAPs	Community Revitalization **(Section VIII.C)**
9%	Up to 10 points achievable for Applications that demonstrate a high Quality of Life Index score and /or meet Community Revitalization Strategies scoring criteria	Community Targeting **(Section IX.C.ii)**
9%	Up to 2 points achievable for Projects located in a non-exempt local government's jurisdiction according to the Affordable Housing Planning and Appeals Act (General Track Scoring only)	Affordable Housing Planning and Appeal Act **(Section IX.C.vi)**
9%	Up to seven or 10 points achievable (non-profit or for-profit, respectively) for Applications with Development Team Participants with BIPOC Development Control or who are WBE/DBE/MBE certified	BIPOC Development Control and Women/Disadvantaged/ Minority Enterprises **(Section IX.D.ii)**
Most Vulnerable Populations		
4%, 9%	Mandatory requirement that Projects dedicate 5% (4% Tax Credit Applications) or 5-10% (9% Tax Credit Applications, dependent upon Set-Aside) of total units to the SRN	Statewide Referral Network **(Section VIII.Q.i)**
4%, 9%	Mandatory requirement that Projects exercise a 10% waitlist preference for veterans in the Tenant Selection Plan ("TSP")	Veterans Housing Preference **(Section VIII.Q.ii)**
9%	Competitive PSH Track Scoring option available for Projects that dedicate 30% or more of their total units to serving Supportive Housing Populations	PSH Track Scoring criteria and categories **(Section IX)**
9%	Up to three points achievable for Projects that incorporate at least a 15% share of accessible units	Additional Accessible Units **(Section IX.A.ii)**
9%	Up to eight points achievable for Projects that dedicate higher shares of total units to populations at extremely low-income levels (General Track Scoring only)	Deeper Income Targeting **(Section IX.E.i.b)**
9%	Up to 22 points achievable for PSH Track Projects and 12 points achievable for General Track Projects via the Most Vulnerable Populations scoring category	Most Vulnerable Populations **(Section IX.F)**
Sustainability and Energy Efficiency		
4%, 9%	Mandatory requirement that Projects adhere to the 2020 Enterprise Green Communities' 40 mandatory project criteria	Enterprise Green Communities **(Section VIII.P)**
9%	Up to seven points achievable for Projects that commit to gaining a qualifying basic level of a green building certification	Green Building Certification: Basic Level **(Section IX.B.i)**
9%	Up to three points achievable for Projects that commit to gaining a qualifying advanced level of a green building certification	Green Building Certification: Advanced Level

9% vs. 4% LIHTC

9% LIHTC	4% LIHTC
Competitive allocation under the QAP	Available if tax-exempt bond financing is used on 50% or more of the project
New construction and rehabilitation (4% LIHTC for acquisition)	Acquisition <u>and</u> rehabilitation New construction
Qualified Basis **x 0.09**	Qualified Basis **x 0.04**
10% test (basis) and Placement in Service deadlines	50% test (tax-exempt bonds), QAP requirements, and financial feasibility

Qualified Basis

- Qualified Low-Income Building
- Applicable Fraction:
  - Lesser of the unit fraction (low-income units/total units) or the floor space fraction (low-income total floor space/total floor space)
- Eligible Basis:
  - Adjusted basis as of end of first taxable year of credit period
  - Depreciable development costs
  - If acquiring existing building, cost of building only (land cost not eligible)

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IHDA 9% Geographic Set-Asides

The Authority's approximate allocation goals for 9% Tax Credits within each Set-Aside are as follows:

Allocation Goal by Set-Aside	
Set-Aside	**9% Allocation Goal**
Chicago Metro	35%
City of Chicago	12%
Non-Metro	20%
Other Metro	18%
Statewide	15%
Total 9% Tax Credit Allocation	**100%**

IHDA 9% Geographic Set-Asides

Geographic Set-Aside Definitions			
Set-Aside	**Description**	**Definition and Boundaries**	**List of Geographies**
Chicago Metro	The metropolitan area comprised of Cook County and its five adjacent counties, but excluding the city of Chicago.	The county boundaries containing DuPage, Kane, Lake, McHenry, Will, and Cook counties, excluding the city of Chicago.	-
City of Chicago	Community areas within the city of Chicago.	The municipal boundary containing the city of Chicago.	-
Non-Metro	Typically rural communities that are not within the contiguous development area of a larger metropolitan region.	Regions that are located outside of any contiguous development metro areas, including all counties with fewer than 50,000 population.	Refer to IHDA's **Set-Aside Look Up tool**
Other Metro	Smaller metropolitan areas outside of the Chicago Metro region with contiguous development.	Metropolitan areas such as Springfield, Peoria, Rockford, etc., including smaller municipalities within an area of contiguous development.	

Section 42 Nonprofit Set-Aside

- At least 10% of a state's LIHTC shall be allocated to projects involving "qualified nonprofit organizations"
  - Section 501(c)(3) or (c)(4) and exempt from federal income tax;
  - Determined by state housing credit agency not to be affiliated with or controlled by a for-profit organization; and
  - Exempt purposes include fostering low-income housing

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How about you?

Would your organization be considered a qualified nonprofit organization under Section 42?

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Is your organization a qualified nonprofit organization under Section 42?

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Section 42 Nonprofit Set-Aside

- Qualified nonprofit organization owns an interest in the project (directly or through a partnership) and
- Materially participates in the development and operation of the project throughout the compliance period

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Material Participation

Only if the nonprofit organization is involved in the actual development and operations of the project on a basis which is:

Regular,

Continuous, and

Substantial.

LIHTC Development Team

- Required Experience by Participant Type
- Property Manager Experience Requirements (post-application)

Development Team Characteristics	14	12
Illinois Based Participants	4	2
FOR-PROFIT TEAM ONLY CHARACTERISTICS	**10**	**10**
BIPOC Development Control*	10	10
Women/Disadvantaged/Minority Enterprises*		
NON-PROFIT TEAM ONLY CHARACTERISTICS	**10**	**10**
BIPOC Development Control*	7	7
Women/Disadvantaged/Minority Enterprises*		
Non-Profit Organization Participation	3	3

IHDA QAP & Non-Profits

Participation of Qualified Non-Profit Organization can earn 3 points if:

- Qualified Non-Profit holds more than 50% ownership interest;
- Control in the general partner or managing member of the Project Owner; and
- Materially participates throughout the Compliance Period

“Control” shall mean:

- Majority ownership interest in the Owner; or
- Majority decision-making authority given in legal documents

IHDA QAP & Non-Profits

The Qualified Non-Profit Organization must submit:

- IRS determination letter; and
- Section of QNP's articles of incorporation or bylaws showing the fostering of low-income housing as an exempt purpose, with that purpose clearly marked and highlighted

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IHDA QAP & Non-Profits

The Qualified Non-Profit Organization must have the **right of first refusal** at the end of the Compliance Period.

Generally, a right of first refusal means that if the Project Owner decides to sell the Project or if a third-party offers to buy the Project, the QNP will have the right to refuse to buy the Project first before the Project's sale to another party can proceed.

Sec. 42(i)(7)(B) sets a minimum purchase price for a right of first refusal in favor of a QNP, roughly the sum of debt plus taxes.

Projects scoring points for QNP participation must check the "Allocation subject to nonprofit Set-Aside under sec. 42(h)(5)" box on IRS form 8609 at the time of tax credit cost certification.

Why NFP Participation

- Section 42 Qualified Non-Profit Organization Set-Aside (10%)
- 3 points under IHDA (draft) QAP; $750 application fee under Chicago QAP versus $1500 for for-profit projects
- Section 42(i)(7) right of first refusal
- Requirement for certain grants/financing, the Illinois Affordable Housing Tax Credit, exemptions from Illinois property taxes and transfer taxes
- May allow for economically advantageous financial structuring, but also require special financial structuring

Illinois Affordable Housing Tax Credits ("IAHTC")

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The IAHTC Program

- One-time tax credit on Illinois state income tax for donors of qualified donations (often referred to as “donation tax credits”)
- IAHTC certificate can be sold to generate more funds for affordable housing project
- Administered by IHDA (75.5% of annual allocation from the state) and City of Chicago (24.5%)
- Governed by Illinois Administrative Code, Title 47, Chapter II, Part 355

IAHTC Definitions

- Affordable Housing Project:
  - Rental project with at least 25% of units having monthly rents not exceeding 30% of gross monthly income of 60% of area median income
  - Rent-restricted units are occupied by 60% AMI or less household
  - Unit for sale to 60% AMI or less (pre-2022) / 120% AMI or less (post-1/1/2022) household who will pay no more than 30% of their gross household income for mortgage principal, interest, property taxes, and property insurance

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IAHTC Definitions

- Donation: Money, securities, real property, or personal property provided without consideration to a Sponsor that is used for:
  - Costs of purchasing, rehabilitating, constructing, or providing or obtaining financing for an Affordable Housing Project, including fees for professionals;
  - Technical Assistance;
  - General Operating Support of the Sponsor;
  - Or an Employer-Assisted Housing Project

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IAHTC Definitions

- Sponsor: A not-for-profit organization that is:
  - organized under state law (any) and has the development of affordable housing or home ownership education as one of its purposes;
  - organized to construct or rehabilitate affordable housing Units and exempt from federal income tax;
  - a community development corporation; or
  - a limited liability company that has a not-for-profit organization as its sole member

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Value of IAHTC

50% of the lesser of:

- Approved amount of Donation; or
- Actual Donation

Example:

- Land appraised at $1M donated for $10 to Sponsor
- Donation = $999,990
- Potential IAHTCs = $499,995

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Basic IAHTC Structure

Sponsor

Donation

Donor

General Partner

Project Owner

IHDA

Sponsor applies for IAHTC based on Affordable Housing Project and Donation; IHDA provides Conditional Reservation Letter for certain amount of IAHTCs

Donor makes an eligible Donation to Sponsor and receives IAHTC certificate:

1. Donor may use the IAHTCs for itself to offset Illinois income tax;
2. Donor may sell the IAHTCs to another entity who wants them;
3. Donor may contribute the IAHTCs to Sponsor as well to increase financial support of Project

IAHTCs = 50% of the lesser of:
Approved Donation Amount
Or
Actual Donation

IAHTC Requirements

- Eligible Donation(s) to Sponsor
- Transfer of IAHTCs to another individual or entity requires a minimum donation to the affordable housing project for which the credits were issued
- Sponsor of Multifamily Housing Project or rental Single Family Project must commit to Material Participation for the full term of the Compliance Period
- IAHTC Regulatory Agreement for rental Affordable Housing Projects

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Cash

Check or wire

Securities

Stocks, bonds, etc.

Certificate of transfer

Close of market value

Real Property

Fee simple interest,
beneficial interest
in land trust,
50-year ground lease,
discounted sale

Personal Property

Construction materials and equipment, art, antiques, coins, jewelry

Services

NOT considered a Donation for IAHTC

State/Local Govt

Money, waived permit fees or other charges, real property, below-market loans

IAHTC Donation Requirements

- Aggregate donation amount of $10,000 or more
- May not take place prior to 3 years before the initial closing date unless otherwise approved by the allocating agency in its discretion
- Sponsor receiving donation must commit to Material Participation for the full term of the Compliance Period (at least 10 years for Affordable Housing Project)

IAHTC Transfer Requirement

- Donor may transfer IAHTC certificate to purchaser of land designated for Affordable Housing Project

or

- To another Donor who has made a minimum Donation of at least 10% of amount of transferred IAHTCs (if less than $100,000 IAHTCs) or $10,000 (if $100,000 or more)

LIHTC-IAHTC Structure

Sponsor

Land Donation +
IAHTC Certificate

Donor

General Partner

IAHTC Certificate

IAHTC Proceeds + Minimum Donation

Donor makes an eligible Donation of land to Sponsor and elects to contribute the IAHTCs to Sponsor.

Sponsor applies for IAHTC based on Affordable Housing Project and Donation; IHDA provides Conditional Reservation Letter for certain amount of IAHTCs

Project Owner

IAHTC Purchaser

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Sponsor sells the IAHTCs to another party. In addition to paying for the IAHTCs, the purchaser must also make a minimum Donation to receive the IAHTCs.

IAHTCs = 50% of the lesser of:
Approved Donation Amount
Or
Actual Donation

Sponsor sells the donated land to the Project Owner and contributes or loans the proceeds from the sale of IAHTCs to the Project Owner.

Sponsor Material Participation

Personal or professional services on a regular, continuous, and substantial basis for more than 300 hours each year of Compliance Period (10 years).

Or

Sponsor is owner, or holds controlling interest in owner, or is the managing general partner/member of owner, or holds controlling interest in such managing general partner/member of the owner.

IAHTC Regulatory Agreement

- Recorded against rental Affordable Housing Projects and Employer-Assisted Housing Projects
- At least 25% of units have rents restricted to 30% of 60% area median income
- Occupied by households whose incomes do not exceed 60% of area median income
- 10-year Compliance Period
- No transfer or material change of ownership structure without agency written approval

Questions?

Jolyn Heun
jheun@att-law.com
(312) 491-4466

C.C. Huang
chuang@att-law.com
(312) 491-4462

Applegate & Thorne-Thomsen
ATTORNEYS AT LAW