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*News, Ideas and Information for
Tax Credit Developers and Investors*

LIHTC Changes Offer Opportunities for Developers, Owners

The new Housing and Economic Recovery Act offers a number of opportunities for developers and owners of both new and existing low-income housing tax credit (LIHTC) projects.

In recent comments, including to the *Tax Credit Advisor*, LIHTC practitioners and program participants highlighted some of these.

Aid for Struggling Deals

Several amendments have the potential to restore viability to proposed projects that have credit awards but funding gaps challenging their feasibility. In many instances, these gaps were created by decreases in the credit pricing received by sponsors compared to what they originally expected.

States now have an extra 10% in per capita credits for each of 2008 and 2009. They can also provide a 30% basis boost to projects in need of extra help for financial feasibility. And, the Act sets the minimum percentage for the 70% present value housing credit at a flat 9%. The last two amendments cover projects placed in service after 7/30/08.

Developers of projects under development that aren't financially sound, irrespective of the year of the credit award (e.g., 2008, 2007, 2006 credits), "have the opportunity to potentially go back to their state allocating agency to get some more tax credit allocation," said San Francisco CPA Michael Novogradac, of Novogradac & Company LLP. "There are a lot of ways that existing deals that are financially challenged will be able to close some of the gap."

As with many of the Act's LIHTC

amendments, it will be up to each state housing credit agency as to how it interprets the new changes and how and when to implement them.

Another amendment, narrow in scope, could give a financial boost to projects saddled with "frozen" LIHTC tenant and income rent limits. This amendment, restricted to certain projects that had initial determinations of tenant income limits in FY 2007 or FY 2008, could enable certain projects to boost their LIHTC rents starting in 2009.

New Projects

The extra per capita credits, minimum 9% credit rate, and potential 30% basis boost from the state agency are available as well to new projects, which also benefit from other amendments.

One eliminates the prior concept of a below-market federal loan. The definition of a federally subsidized building limited to the 4% credit is narrowed to mean only buildings financed by tax-exempt private activity bonds. As a result, all other new construction or substantial rehab projects qualify for the 9% credit. Before, projects were limited to the 4% credit if they had a loan from federal funds at an interest rate below the Applicable Federal Rate. The 4% rate also generally applied to projects assisted by HUD HOME or Native American housing assistance funds.

Washington, DC attorney Richard Goldstein, a partner in Nixon Peabody LLP, noted, for instance, that projects receiving any federal subsidies other than tax-exempt bonds, such as HUD HOME or HOPE VI subsidies, will now be

able to qualify for the 9% tax credit. “That gives you a lot more flexibility, and a good deal simpler execution on your transaction.”

Sources said loans capitalized by federal funds can now also carry an interest rate below the AFR and the project still receive the 9% credit. This will effectively provide more subsidy to projects. In addition, it is easier with low-interest loans to demonstrate an expectation that the debt can be fully repaid by the end of the loan term, as the tax rules require for an obligation to qualify as debt. Boston CPA John Mackey, of Reznick Group, said this should especially help tax credit transactions that need substantial subsidies such as public housing revitalization projects.

Novogradac and Mackey, though, cautioned developers to be careful if thinking of restructuring existing debt to try to lower the interest rate. They pointed out such a change could trigger taxable income and reduce tax losses for investors.

Sources said deal structuring will be made easier by an amendment that clarifies the treatment of federal grants and that directs the IRS to amend its rules to provide that 12 specific types of federal payments (e.g., rental, operating subsidies) and similar state subsidies won't be treated as grants. Legislative language also clarifies that loans capitalized by federal grants won't be treated as federal grants.

Washington, DC attorney Kristin Neun, a partner in Hessel, Aluise and Neun, P.C., said the change, for example, eliminate the previous need for complex structures, to maximize the housing credits, for transactions involving existing HUD Section 236 projects with “decoupled” Interest Reduction Payment (IRP) streams.

Rural Projects

Several amendments could encourage additional new tax projects and assist existing projects in rural areas.

One change provides for tenant income and rent limits for LIHTC units for projects in rural areas to be based on the greater of the: (1) HUD area median gross income; or, (2) the national non-metropolitan median income (currently \$49,300), for determinations after 7/30/08 for new and existing buildings. Before, rural project tenant income and rent limits were pegged to the HUD

median income. Joe Guggenheim, Bethesda, MD-based LIHTC consultant and author, said this change might provide “a little more impetus for rural projects.”

Novogradac and CPA George Littlejohn, also with Novogradac & Company LLP, pointed out that this change will benefit some but not all rural areas. In areas that benefit, projects will be entitled to a higher LIHTC tenant income limit, broadening the pool of qualified potential renters. They will also be entitled to a higher rent, but whether this is achievable will depend on market conditions.

The elimination of the below-market loan concept will also mean that projects with 1% USDA Rural Housing Service Section 515 loans are now eligible for the 9% tax credit.

The Act also contains non-tax amendments that direct RHS to take actions to expedite approvals of transfers of existing Section 515 projects.

Acquisition/Rehab, Preservation Deals

Several amendments favor tax credit acquisition/rehabilitation and preservation transactions.

One change broadens the universe of projects that qualify for waivers of the so-called 10-year rule. Under this rule, the purchaser of an existing project can't qualify for housing credits for acquisition costs, if the property was last placed in service, or had a major improvement, in the past 10 years.

Under prior law, two exceptions allowed a waiver of the 10-year rule to avert assignment of the mortgage, mortgage prepayment, or certain other negative consequences for federally-assisted projects. This term meant projects substantially assisted, financed, or operated under HUD's Section 8, 221(d)(3), and 236 programs, and the RHS Section 515 program.

The Act creates a revised single exception that expands the previous list to add projects substantially assisted, financed, or operated under: HUD's popular Section 221(d)(4) program; any other HUD or RHS programs; and similar state programs.

Under the 10-year rule, for the purchaser of a property to qualify for acquisition credits, the buyer can't have purchased the property from a “related” party. The Act raises the threshold

above which there is a related party to 50% from 10% previously. This means a partner in the purchasing entity that was also in the selling entity won't be deemed to be a related party unless this partner has more than a 50% interest in the new partnership.

Sources said this should enable and encourage the transfer and sale of more existing properties for syndication with tax credits for the first time, and resyndication and rehabilitation with new tax credits, including old HUD and tax credit properties.

Mackey expected many developers will now revitalize, with new tax credits, properties that they originally developed, as the developer and general partner of a new partnership that acquires the property from the developer's prior partnership. He said the previous 10% threshold has "caused many partnerships that might have been revitalized to limp along, because the general partner (GP) or in some cases the limited partner (LP) – don't want to turn them over." In many cases, he added, developers originally had a 50% residual interest in the property that would preclude them from more than a 10% interest on the buy side, making a new deal unattractive. With the change, Mackey explained, a developer can get a 50% interest on the buy side, take out the equity he or she earned in the old partnership, facilitate the exit of limited partners who don't want to stay on, collect a development fee, and protect his or her management contract.

Syndicator Ronne Thielen, of New York City-based Centerline Capital Group, said that as a result of the related party threshold increase, "Transferring interests – either GP interests or LP interests – will be made easier."

Boston-based Richard Floreani, of Ernst & Young LLP, said the related party threshold increase should make it easier to take properties from an existing multi-investor housing credit fund, resyndicate them with new credits, and place them in a new multi-investor fund, because most multi-investor funds don't have a single investor with an interest above 50%.

Neun suggested use of housing credits for HUD-insured or – assisted projects is made easier by various non-tax amendments in the Act designed to remove prior impediments and streamline HUD requirements and procedures. She particularly cited a provision overturning

HUD's prior general requirement that sponsors bring the full amount of housing credit equity to the closing table for an FHA-insured mortgage. □