

LIHTC MONTHLY REPORT

A MONTHLY PUBLICATION OFFERING NEWS, OPINION, FEATURES AND COMMENTARY ON THE LOW-INCOME HOUSING TAX CREDIT INDUSTRY

February 2006, Volume XVII, Issue II, Published By Novogradac & Company LLP

Hurricane Relief and Opportunities Arrive With New Legislation: Gulf Opportunity Zone Act of 2005

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On December 21, 2005, President George W. Bush signed H.R. 4440, a mix of hurricane relief measures to encourage the much-needed clean-up and rebuilding of the Gulf region. At the center of this news is evidence of the government's confidence in its tax credit programs – low-income housing tax credits, historic credits and new markets tax credits. The new law is utilizing these programs specifically as a tool to attract developers and investors to assist the region.

For the Low-Income Housing Tax Credit (LIHTC) program, several attractive features are included. These include increasing tax credits available to the affected Gulf Opportunity Zone, or "GO Zone" (Hurricane Katrina-affected area), in an amount equal to \$18 per capita (based on the latest census data) for the area per year, for the years 2006 to 2008. In addition, Texas and Florida will have \$3.5 million additional credits in 2006. In consideration of LIHTC compliance, projects that consist of tenants misplaced by Hurricane Katrina can rely on tenant representations that their income will not exceed the income limits for the rental unit.

The GO Zone and areas affected by hurricanes Rita and Wilma, will be considered difficult to develop areas (DDAs), receiving the 130 percent eligible basis boost; however, credits must be allocated and projects must be placed in service in the years 2006 to 2008, and for bond deals, bonds must be issued in the years 2006 to 2008 and the property placed in service by the end of 2008. These hurricane DDAs will not be considered in the 20 percent cap on designated DDAs that exists nationwide.

The Texas tax credit agency has released an announcement indicating immediate use of the DDA basis boost in LIHTC application submittals. The affected Hurricane Rita area includes the counties of: Angelina, Brazoria, Chambers, Fort Bend, Galveston, Hardin, Harris, Jasper, Jefferson, Liberty, Marion, Montgomery, Nacogdoches, Newton, Orange, Polk, Sabine, San Augustine, San Jacinto, Shelby, Trinity, Tyler and Walker. Similar announcements are expected from other affected states.

Another important provision of the law is the use of 50 percent bonus depreciation for new construction property located in the GO Zone. This will be applicable to personal property and site improvements covered under previous bonus depreciation rules, and also residential and nonresidential real property. The original use of the property must commence on or after August 28, 2005, and must be placed in service before the end of the year 2007. Residential and nonresidential real property must be placed in service before the end of the year 2008. This change alone should have a significant impact on the price paid by investors for acquiring an interest in an LIHTC partnership. The ability to receive significant losses earlier in the tax credit period should increase the pricing available for tax credits. However, the bonus depreciation is not available for property that is financed with tax-exempt bonds or that is tax-exempt use property.

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The model on page four is a sample forecast for a new construction low-income housing tax credit deal, where initially there is a significant deferred developer fee. With the use of the DDA basis boost and the bonus depreciation, the deferred developer fee is replaced by additional investor equity, which allows for excess cash to be paid out to the general partner/developer entity as incentive management fees. The change in yield is substantial, as shown on page four.

In addition to bonus depreciation, the law provides a tax incentive for clean-up costs. Costs incurred for the removal of debris or demolition of structures on real property in a GO Zone are allowed a 50 percent deduction in the year the cost is incurred, for the period from August 28, 2005 to December 31, 2007.

Like the low-income housing tax credits, rehabilitation tax credits (for buildings constructed prior to 1936 or for certified historic structures) will see a similar increase in the GO Zone. Qualified rehabilitation expenditures incurred between August 28, 2005 and December 31, 2008 that would have been previously subject to a 10 percent historic tax credit percentage will be increased to 13 percent. Certified historic structures previously subject to a 20 percent rate will be increased to 26 percent.

New markets tax credits (NMTCs) will increase by \$300 million for 2005 and 2006 and by \$400 million in 2007. This will apply to community development entities with a focus on the recovery and redevelopment of the GO Zone region. The Coalition to Reauthorize New Markets Tax Credits issued a press release commending Sen. Trent Lott of Mississippi for "his leadership in advocating for this much-needed tax credit."

The new law allows for the issuance of GO Zone Bonds, tax-exempt bonds available to be issued by Alabama, Mississippi, Louisiana, or a subdivision therein. The state cap for GO Zone bonds will be \$2,500 per capita for the applicable GO Zone area. The bonds must be issued between December 21, 2005 and January 1, 2011. Bond proceeds may be used for residential rental property under the LIHTC program in the GO Zone, for acquisition and rehabilitation of nonresidential real property in the GO Zone, or for public utility property; notwithstanding, no proceeds can be used for personal property items that could potentially be removed from the GO Zone. Also, since GO Zone bonds are not volume cap bonds, there is no "automatic" allocation of LIHTCs to projects financed with those bonds. Thus, an allocation of LIHTCs will be necessary in addition to an allocation of GO Zone bonds.

Tax-exempt GO Zone bonds used for acquisition/rehabilitation projects must be used primarily for rehabilitation costs; the new law requires that rehabilitation costs must exceed 50 percent of the acquisition price rather than the unused 15 percent required in Section 42. IRC Sec-

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ISSN 1094-8684

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tion 42, which covers LIHTC projects, requires that a minimum set-aside election be established at either 20/50 (20 percent of units at 50 percent of the area median income) or 40/60. If GO Zone Bonds are being used, but not LIHTCs, the set-aside has been modified to 20/60 or 40/70.

The Gulf Opportunity Zone Act of 2005 should create a heightened focus on development opportunities in the Gulf region. It would not be a surprise to see appreciation of property values in response to this package of tax incentives. The federal government has created the opportunity and the individual states will be responsible for administering much of it. ❖

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Hurricane Relief and Opportunities

SAMPLE GO ZONE PROJECT
BEFORE TAX LAW CHANGE
FINANCIAL PROJECTION
ESTIMATED LIMITED PARTNER RETURN

Date	Capital Contrib.	Tax Credits	Cash Distrib.	Cash and Credits	Annual Return	Cumul. Return	Income (Losses)	Tax Sav. (Cost)	Cumul. Net Benefits	Ending Cap. Acct.
2006	13,937,205	613,815	0	613,815	4%	4%	(903,380)	929,998	(13,007,207)	13,033,825
2007	0	1,444,270	47	1,444,317	10%	15%	(433,422)	1,595,968	(11,411,193)	12,600,356
2008	0	1,444,270	47	1,444,317	10%	25%	(398,713)	1,583,819	(9,827,326)	12,201,597
2009	0	1,444,270	47	1,444,317	10%	35%	(366,036)	1,572,382	(8,254,897)	11,835,514
2010	0	1,444,270	47	1,444,317	10%	46%	(340,397)	1,563,409	(6,691,440)	11,495,069
2011	0	1,444,270	47	1,444,317	10%	56%	(305,324)	1,551,133	(5,140,260)	11,189,699
2012	0	1,444,270	47	1,444,317	10%	67%	(270,764)	1,539,037	(3,601,175)	10,918,887
2013	0	1,444,270	29,293	1,473,563	11%	77%	(508,896)	1,622,384	(1,949,499)	10,380,699
2014	0	1,444,270	36,650	1,480,920	11%	88%	(549,363)	1,636,547	(276,302)	9,794,685
2015	0	1,444,270	38,518	1,482,788	11%	98%	(539,595)	1,633,128	1,395,344	9,216,573
2016	0	830,455	40,413	870,869	6%	105%	(529,066)	1,015,628	2,451,386	8,647,093
2017	0	0	42,337	42,337	0%	105%	(518,046)	181,316	2,675,039	8,086,709
2018	0	0	44,289	44,289	0%	105%	(506,180)	177,163	2,896,492	7,536,240
2019	0	0	46,269	46,269	0%	106%	(493,730)	172,805	3,115,566	6,996,241
2020	0	0	48,278	48,278	0%	106%	(480,334)	168,117	3,331,961	6,467,630
2021 -sale	0	0	0	0	0%	106%	(6,467,630)	2,263,670	5,595,631	0
							(\$13,610,875)	\$19,206,506		

Credit Price: **0.9650** Annual After-Tax Internal Rate of Return (IRR) 6.24%

SAMPLE GO ZONE PROJECT
AFTER TAX LAW CHANGE
FINANCIAL PROJECTION
ESTIMATED LIMITED PARTNER RETURN

Date	Capital Contrib.	Tax Credits	Cash Distrib.	Cash and Credits	Annual Return	Cumul. Return	Before change			New Income (Losses)	Tax Sav. (Cost)	Cumul. Net Benefits	Ending Cap. Acct.	
							Income (Losses)	Change in interest	Change in depreciation					
2006	20,089,795	797,959	28,351	826,310	4%	4%	(903,380)	72,608	(8,795,944)	(255,130)	(9,881,846)	4,256,605	(15,804,839)	10,179,598
2007	0	1,877,551	58,644	1,936,195	10%	14%	(433,422)	288,591	364,072	(527,319)	(308,078)	1,985,378	(13,760,817)	9,812,876
2008	0	1,877,551	60,937	1,938,488	10%	23%	(398,713)	285,488	354,934	(547,954)	(306,244)	1,984,736	(11,715,144)	9,445,696
2009	0	1,877,551	60,887	1,938,438	10%	33%	(366,036)	282,161	348,164	(547,504)	(283,214)	1,976,676	(9,677,581)	9,101,594
2010	0	1,877,551	62,615	1,940,166	10%	43%	(340,397)	278,593	344,623	(563,051)	(280,233)	1,975,632	(7,639,334)	8,758,747
2011	0	1,877,551	64,370	1,941,921	10%	52%	(305,324)	274,767	339,258	(578,850)	(270,149)	1,972,103	(5,602,860)	8,424,228
2012	0	1,877,551	66,154	1,943,705	10%	62%	(270,764)	270,665	335,594	(594,900)	(259,405)	1,968,343	(3,568,364)	8,098,669
2013	0	1,877,551	67,965	1,945,516	10%	72%	(508,896)	266,266	335,594	(348,018)	(255,053)	1,966,820	(1,533,579)	7,775,651
2014	0	1,877,551	69,805	1,947,356	10%	81%	(549,363)	261,550	335,640	(298,363)	(250,536)	1,965,239	501,464	7,455,310
2015	0	1,877,551	71,672	1,949,223	10%	91%	(539,595)	256,492	335,679	(298,363)	(245,787)	1,963,576	2,536,713	7,137,851
2016	0	1,079,592	73,568	1,153,160	6%	97%	(529,066)	251,068	335,640	(298,363)	(240,720)	1,163,844	3,774,125	6,823,563
2017	0	0	75,492	75,492	0%	97%	(518,046)	245,253	335,679	(298,363)	(235,477)	82,417	3,932,034	6,512,594
2018	0	0	77,444	77,444	0%	98%	(506,180)	239,017	335,640	(298,363)	(229,885)	80,460	4,089,938	6,205,264
2019	0	0	79,424	79,424	0%	98%	(493,730)	232,331	335,679	(298,363)	(224,083)	78,429	4,247,791	5,901,758
2020	0	0	81,432	81,432	0%	98%	(480,334)	225,161	335,640	(298,363)	(217,895)	76,263	4,405,486	5,602,430
2021 -sale	0	0	0	0	0%	98%	(6,467,630)				(5,602,430)	1,960,851	6,366,337	0
							(\$13,610,875)	(\$19,091,035)	\$25,457,372					

Credit Price: **1.0700** Annual After-Tax Internal Rate of Return (IRR) 6.51%