

## Housing Act Provides New Ways to Close LIHTC Financing Gaps

By Michael J. Novogradac, CPA

The Housing and Economic Recovery Act of 2008 (H.R. 3221), signed into law on July 30, has presented the affordable housing industry with some of the most sweeping changes to the Low-Income Housing Tax Credit (LIHTC) program since its inception in 1986.

In last month's Washington Wire we addressed some of the investor incentives included in that legislation. This month we review some of the ways the Act helps developers close LIHTC financing gaps. These financial feasibility issues are of great interest to investors and developers.

Among the several affordable housing provisions of H.R. 3221 are an increase in credit allocation, an additional \$11 billion in tax-exempt bonds, a temporary 9 percent minimum credit rate, an additional 30 percent basis boost, and the elimination of the federal subsidy taint from tax credit projects.

### 20 Cents More in Tax Credits

The 20-cent increase for all large states and 10 percent increase for all small states for 2008 and 2009 are designed to make projects work better.

In California in 2008, based on its per capita population, the state received about \$73 million in tax credits for 2008. Under the new law, California will receive an additional \$7.3 million, or a total of more than \$80.4 million, for 2008. In contrast, the small state of Rhode Island received about \$2.3 million in tax credits in 2008 and will receive an extra 10 percent, or \$230,000 in additional credit, for 2008 and 2009.

A key question is how state housing agencies will treat these additional tax credits because it appears they will need to allocate them this year in order to participate in next year's pool of returned credits. This means amending their QAPs in order to get out the additional credits and many states are working aggressively to determine how to handle the allocations.

The Texas Department of Housing and Community Affairs' (TDHCA) announced last month that all 2007 competitive awards that had not closed as of September 3, 2008 will be allocated additional housing tax credits from the 2008 ceiling, based on an evaluation of the developments using the gap method. These additional allocations will allow for new syndication pricing letters and a 9 percent tax credit rate applied to qualified basis. In addition, all 2007 competitive awards that had closed as of September 3, 2008, as well as all 2008 awards that want consideration for additional credits, will have the opportunity to submit specific evidence for re-evaluation. Details about TDHCA's policy for allocating the additional LIHTC cap can be downloaded in the September 9, 2008 installment of the Novogradac Report on Tax Credits, a weekly podcast that can be found online at [www.novoco.com/podcast](http://www.novoco.com/podcast).

In California, the California Tax Credit Allocation Committee (TCAC) announced that as a result of the Housing Act's providing an additional 20 cents per capita in 2008, it is making the additional \$7.3 million available to pending second round applicants of 9 percent credits by cascading the additional credits through the various set-asides and geographic apportionments.

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We are very pleased with these actions because they are very responsive to the challenges being faced by developers of affordable housing in Texas and California. We encourage developers to get involved in sharing with housing agencies their ideas on how to administer the added tax credits and be an active voice in the process.

## \$11 Billion More in Tax-Exempt Bonds

H.R. 3221 provides an additional \$11 billion of tax-exempt housing bonds (TEB) that can be used only for three purposes: multifamily rental housing projects, qualified mortgage issues for for-sale home ownership and sub-prime mortgage refinancing. For California that means an additional \$1.1 billion in TEBs, \$571 million for Florida, \$97 million for Nevada, \$359 million for Ohio and \$749 million for Texas.

The key here is that while nationwide there is more than \$30 billion in tax exempt bond authority that can be used for housing and non-housing purposes, the Housing Act has added about 28 percent of bond authority to the mar-

ket that has to be used just for housing, even if it carried forward to future years. Here too developers should engage with allocating authorities to play a role in guiding housing agencies on balancing the best uses of these additional TEBs. We should also be aggressive in ensuring these additional bonds do not cause the agencies to reduce other bond allocations for housing.

## Temporary 9 Percent Minimum Credit Rate

The credit percentage for new projects and substantial rehabilitations that are placed in service after July 30, 2008 and before December 31, 2013 is now at least 9 percent. It does not apply to the acquisition of projects financed by tax-exempt bonds; rates on those will still float.

This means that a building that had an adjusted eligible basis of \$10 million and a credit percentage of 7.94 percent, and which generated annual credits of \$794,000, would in 10 years provide \$7.94 million of annual credits. Under the new 9 percent minimum rate, the building

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now would have the potential to generate \$900,000 in annual credits and \$9 million over 10 years.

The 9 percent credit could also be used to mitigate some of the investor turmoil we've seen. If an existing \$7.94 million deal was underwritten last year at 93 cents and generated about \$7.3 million of investor equity, it would, using the 9 percent rate and 80 cents as a current market rate, generate \$7.2 million. While not quite the total equity, this example does show how the 9 percent credit rate could help mitigate against some of the effects of lower credit prices.

It is important that our readers be aware that the 9 percent minimum credit rate is a floor so if we get into a rising interest rate environment, the credit percentage, in theory, could go above 9 percent.

There are some other areas of caution with the 9 percent minimum rate, including the unfortunate choice of the December 31 placed-in-service date. As we get closer to 2013, developers will encounter what promises to be a challenging underwriting situation. A better effective date would have been based on allocations. This is one of the areas where the industry will need to work with Congress to get the placed-in-service date extended or at least changed so that it's effective for allocations in specific years.

Projects with existing allocations face another dilemma; whether the lock-in of the credit percentage in a prior year might limit their ability to use a higher credit percentage. A preponderance of tax attorneys now think if a project locked in a lower percentage in a prior year, the 9 percent statutory mandated minimum trumps that; however, the issue isn't free of doubt and it remains to be seen to what degree we will need to have IRS guidance. For more on the locked-in subject, see "Transitioning to the Flat 9% Credit Percentage: How Locked-in is Locked-in?" in the September issue of the Novogradac Journal of Tax Credit Housing.

## The 130 Percent Boost

In addition to qualified census tracts (QCTs) and difficult

to develop areas (DDAs), Congress added a third type of designation when crafting H.R. 3221. A state housing credit agency may designate an individual project as eligible for a 130 percent boost if it meets two basic requirements: it must be project based (not an area based allocation or methodology) and the project must need the additional 30 percent to be financially feasible. This is effective for buildings placed in service after July 30, 2008. This additional 30 percent boost is not available to tax-exempt bond financed projects.

This is good news for developers whose projects might not have been feasible in the past, it makes such projects more feasible. It is also an area where the states will have a lot of latitude because the only requirement is that a project will need the credits for feasibility. Because states allocate based on such need and there is really no significant limitation, it will be a matter of how the states will determine which of those projects that are not in a QCT or DDA will receive this added boost.

This area provides yet another opportunity for developers to provide a voice in how a state should be implementing this rule.

A report of the Joint Committee on Taxation, which explains the provisions, contains some areas that are not entirely consistent with the statute, blurring some of the guidance that the states will be receiving on how to implement the rule. We may or may not need additional IRS guidance on these aspects depending on how the states interpret the statute and how much weight they give to the Joint Committee's report.

## Federal Subsidy Taint Limited

Finally for this month's edition of the Washington Wire, the Housing Act limits the federal subsidy taint to tax-exempt bond financing. Previously, projects financed by debt on which interest was exempt from taxation and that used below market federal financing were generally eligible for only the 4 percent credit. "Below market federal financing" has been removed from the definition, which means that for certain projects that received some federal financing that was not bond financing they can

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now enjoy increases in their effective credit percentage from 3.40 percent to 9 percent, effective for buildings placed in service after July 30, 2008.

This significant provision means the industry will no longer have to deal with the complex structuring of below-market HOME funds, charge interest at AFR (applicable federal rate), and accrue interest at AFR on federal loans and will make projects a lot easier to underwrite.

## Conclusion

The new bill includes a significant number of positive changes but as I noted previously it also leaves some lingering questions and concerns on several of its LIHTC aspects. Some partial guidance was forthcoming last month when the Internal Revenue Service (IRS)

published Notice 2008-79, which provides guidance on allocations, carryforwards, information reporting and uses of the additional bond volume cap provided by the Housing Act. In addition, the notice provides guidance regarding the provision that allows LIHTC and TEB financed properties to disregard basic housing allowance payments at certain military bases for purposes of applicable low-income set-aside income limitations.

Novogradac and Company is convening an LIHTC Working Group that will identify areas that require additional guidance and will work with the Internal Revenue Service (IRS) to solicit and receive that guidance. For more information on the Working Group, please contact Mike Morrison at Mike.Morrison@novoco.com or 415.356.8025. ❖

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