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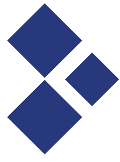

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THE LIHTC Property Compliance ISSUE

NCSHA's LIHTC Recommended Practices Seek to Strengthen State-Level Credits

The National Council of State Housing Agencies released recommended practices for housing credit administration, including a new section on tenant protections.

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Average Income: Back to Basics Six Years After Set-Aside Test's Implementation

Although the average income test has some compliance quirks, its implementation can result in a more robust tenant population and can subsidize lower income units.

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The Housing Opportunity Through Modernization Act has the potential to have a significant impact on income eligibility.

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How LIHTC Swapdowns and Swapups Benefit Both Tenants and Owners

Learn about the multiple advantages to reassigning tenants in a higher set-aside unit to a lower set-aside or recertifying a lower set-aside household at a higher income.

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Considerations and Issues When Twinning NMTC with Other Incentives

MICHAEL K. WONG, CPA, NOVOGRADAC

Q: What considerations and issues should be examined when twinning the new markets tax credit (NMTC) with other incentives?

A: When developers contemplate a development using tax incentives, there are many options. The most common community development tax incentives include NMTC, low-income housing tax credit (LIHTC), historic tax credit (HTC) and opportunity zones (OZ) incentive. Each has its unique emphasis and requirements. The NMTC incentive emphasizes nonresidential developments within low-income census tracts, the LIHTC incentive emphasizes affordable housing developments, the HTC incentive emphasizes rehabilitation of historic structures and the OZ incentive emphasizes community developments within qualified OZs. For projects that qualify for NMTC, a developer might also explore the ability to use the LIHTC, HTC and OZ incentives to maximize available resources.

Twinning NMTC and LIHTC

If the project is a mixed-use development consisting of commercial spaces and affordable housing units, the developer might consider using the NMTC and LIHTC incentives. There are a couple of issues with that plan: first, project costs financed by LIHTC equity cannot be financed by the NMTC program simultaneously; and second, to qualify for NMTCs, the project must be a nonresidential property, but such classification would jeopardize the project's qualification for LIHTCs. These factors make it impossible to structure projects wishing to use both the NMTC and LIHTC incentives in the same financing structure. Fortunately, a structure can be used that legally separates the commercial and affordable housing components of a building into two distinct ownership entities—a structure commonly referred to as the condominium structure. Under the condominium structure, the distinct ownership allows financing the commercial component of the project through the NMTC structure and the affordable housing component to be financed through the LIHTC structure.

Another issue is the difference in compliance periods between the two incentives. NMTC-financed property has a seven-year compliance period and the LIHTC incentive has a 15-year compliance period. Thus, the moment the commercial component reaches the end of the NMTC compliance period, the affordable housing component has eight years of compliance remaining. This considerable gap can create some challenges for developers.

Twinning NMTC and HTC

When developing an NMTC project that is a historic structure, the developer might consider using the NMTC and HTC incentives. The key hurdle with twinning NMTC and HTC is the issuance of Revenue Procedure (Rev. Proc.) 2014-12, which establishes a safe harbor in which the IRS will not challenge the allocation of HTCs if the transaction is structured in accordance with the revenue procedure. One of the safe harbor provisions restricts investors from holding an ownership interest in the landlord when the investors receive an allocation of HTC from the prime tenant. Another provision restricts the prime tenant from loaning funds to the investor to acquire their partnership interest. These restrictions make twinning NMTC and HTC in the

same structure challenging. As such, to satisfy the safe harbor rules provided by Rev. Proc. 2014-12, an investor would separate its NMTC equity and HTC equity. On the NMTC side, the typical NMTC structure is used where the investor contributes NMTC equity to the investment fund, which also receives a leverage loan. Combining the leverage loan and NMTC equity proceeds, the investment fund makes a qualified equity investment (QEI) to the sub-community development entity (CDE) and the sub-CDE makes a qualified low-income community investment (QLICI) loan to the qualified active low-income community business (QALICB). On the HTC side, the investor contributes HTC equity to the prime tenant for a 99% ownership interest, with the remaining 1% ownership interest held by the prime tenant's managing member. The prime tenant then contributes the proceeds to the QALICB, which serves as the landlord in a typical HTC structure.

The difference in compliance period also exists when twinning the NMTC and HTC incentives. While the seven-year NMTC compliance period starts on the date of the QEI, the five-year HTC compliance period starts on the date a qualified rehabilitated building is placed in service. Depending on the length of the construction, the compliance periods of both NMTC and HTC programs can end at around the same timeframe, but developers should still be aware of the potential gap in the compliance periods.

Twinning NMTC and OZ

If the project is a nonresidential property on a census tract that qualifies as both a low-income census tract and as a qualified OZ, the developer might consider using the NMTC and OZ incentives. Under the rules of the OZ incentive, proceeds received by a qualified OZ business must be in the form of equity investments. The requirement creates an issue with twinning NMTC and OZ incentives, since the QALICB, which also serves as a qualified OZ business in the OZ structure, typically receives QLICI from the sub-CDE in the form of a loan. Thus, similar to the twinning of NMTC and HTC incentives, the twinning of NMTC and OZ incentive would typically involve separate NMTC and OZ structures. On the NMTC side, the typical NMTC structure as previously described is used. On the OZ side, in a structure commonly preferred by participants, the investor contributes OZ equity into a qualified opportunity fund (QOF), and the QOF makes an equity investment to the QALICB.

Although the OZ incentive does not have a compliance period, the investor needs to hold its interest in a QOF for at least 10 years to maximize the tax benefits–creating a three-year gap from the seven-year NMTC compliance period.

Developers should examine the considerations and issues discussed as they are looking into twinning NMTC with other incentives for their projects. Novogradac is experienced in these types of transactions and in navigating through these difficult tax areas. Please contact your Novogradac tax advisor with any questions. ❖

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