So You Want to Be a LIHTC Developer: Final Cost Certifications

In this installment of the "So You Want to Be a LIHTC Developer" series, Michael Novogradac, CPA, and guests Warren Sebra, CPA, discuss final cost certifications, one of the necessary benchmarks for receiving low-income housing tax credit (LIHTC) equity. They discuss cost certification basics, examples of eligible costs, ways to enhance eligible basis and tips and recommended practices for LIHTC developers.

Summaries of each topic:

1. Introduction (00:00-4:17)
2. Cost Certifications Overview (4:18-17:22)
3. Examples of Eligible Costs (17:23-29:19)
4. Ways to Enhance Eligible Basis (29:20-32:12)
5. Tips and Recommended Practices (32:13-39:33)
6. Exit (39:34-42:01)
7. Off-Mike (42:02-48:23)

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Transcript

Introduction

[00:00:11] Michael Novogradac, CPA: Hello, I'm Michael Novogradac and this is Tax Credit Tuesday. This is the November 22nd, 2022, podcast. This week's episode is another installment in our ongoing "So You Want to be a LIHTC Developer" series. We launched this series to help real estate developers get a better understanding of the most successful affordable housing production incentive in the country, the low-income housing tax credit.

This series is designed for you if you're a developer interested in using the low-income housing tax credit for the first time, or perhaps you've recently started a role with a low-income housing tax credit developer and you're tuning in for introduction to low-income housing tax credit basics. Or maybe you're an investor or lender who wants to better understand the developer role.

No matter what role you play or hope to play in a low-income housing tax credit transaction, this series is meant for you. Our November 1st episode of the podcast looked at location and market considerations when assessing the financial feasibility of a possible low-income housing tax credit development. We will link to that episode and other LIHTC basics episodes in today's show notes. So be sure to check those out. Also, if you have a particular topic or question you'd like us to address in future episodes of the podcast, please email them to cpas@novoco.com. We'd love to hear from you.

Now turning back to today's podcast. Today's episode deals with a topic that directly affects how much equity a low-income housing tax credit development can receive.

We're talking about final cost certifications. Now we'll get into the definition of a cost certification in more detail during the today's podcast discussion. But for now, just know that the cost certification is a critical component of a low-income housing tax credit transaction, a critical piece of the timeline.

If you complete your final cost certification in a timely manner and everything else is in place, then your development will likely be funded as anticipated by your equity. However, if your final cost certification is not completed in a timely and accurate manner, you'll likely be facing delays in receiving some equity contributions, and you could even face a reduction in the total equity contributed by your equity investor.

Conversely, a little bit more optimistically, if your cost certification shows more tax credit basis than initially anticipated, you might be eligible to receive more tax equity than anticipated, depending on the terms of your partnership agreement, any upward adjusters and your credit award from the state. Now, in short, delays and inaccuracies in a cost certification can cost you time and money.

Limiting delays and ensuring that you capture as much tax credit basis as possible could lead to additional tax credit equity contributions from your investor. That's why it's so important to work with an accountant who's experienced with final cost certifications for low-income housing tax credit properties.

And that is a great segue and introduction to our guest today, my partner, Warren Sebra. Warren is a partner in Novogradac's Portland, Oregon, office. He is a one of our leading low-income housing tax credit experts and helps produce Novogradac's Low-Income Housing Tax Credit Handbook every year in his work with low-income housing tax credit developers. Warren has extensive experience helping clients navigate the ins and outs of cost certifications. He has plenty of insights, tips and examples to share.

Now I'm going to break today's topic down into four key sections. First, we'll discuss a basic overview of cost certifications. Second, we'll share some examples of costs that are included in tax credit basis as well as costs that are not included.

Third, we'll discuss some approaches to calculating tax credit basis that boost eligible basis that many developers aren't aware of. Fourth, we'll wrap up some additional tips and recommended practices that developers should know about final cost certifications. So be sure to listen through the end. We have a lot of ground to cover, so if you're ready, let's get started.

Cost Certifications Overview

[00:04:18] Michael Novogradac, CPA: Warren, welcome back to Tax Credit Tuesday.

[00:04:22] Warren Sebra, CPA: Thanks, Mike. It's, great to be here.

[00:04:25] Michael Novogradac, CPA: So let's dive right in. As I mentioned in my introduction, this is a series about low-income housing tax credit basics. Many of our listeners might have little or no direct experience with low-income housing tax credit cost certifications. So bearing that in mind, Warren, could you please explain to our listeners in more detail what a low-income housing tax credit cost certification is, and maybe more importantly, why it's important.

[00:04:51] Warren Sebra, CPA: Thanks, Mike. You know, when I, get a call from a, new developer or new person looking at affordable housing and specifically the low-income housing tax credit, that's one of one of the first questions they ask. If I hear about this cost certification, what is it and why is it so important? I think first it's important to know that the cost certification is an audit of the uses of the construction cost.

Sometimes states will require the construction sources and permit sources on there, but the real important thing is an audit of the use of construction and that audit will help calculate what's called eligible basis or easy tax credit basis. And from there, that tax credit basis and the final cost certification is going to be submitted to the state allocating agency.

And also your investors are going to be required to look at that as well and to approve it. And when it's submitted to the state allocating agency, you kind of are, it's for the 8609s, and it's kind of the key that unlocks those 8609s. There's a lot of other things you submit to the allocating agency, but the final cost certification is one of the most important documents to, to prepare the 8609s.

And when you have those 8609s, it's kind of like your golden ticket to claim credits. You'll be able to claim those credits on your tax return and also it triggers capital infusion to the property. Your investor will have certain benchmarks that need to be met before you receive all of your equity.

Typically, at close, you may receive between 15, 25% of your equity, but then the benchmarks will have to meet to receive the rest of your equity and receiving. A certified cost certification by an accountant is one of those benchmarks along with 8609s from the state.

[00:06:38] Michael Novogradac, CPA: So, thank you for that overview.

The cost certification is certainly a critical benchmark, as you noted, to receiving one of, at different stages, one of the stages, or a few of the stages of your anticipated equity contributions. So maybe for listeners who aren't aware, you know, at what point in the development process is the final cost certification submitted, and to whom is it submitted?

[00:07:03] Warren Sebra, CPA: Great. When I look at the process or the phases of a development, I look at that in five different phases before a development's closed. First you have your pre-development, where you're hiring an architect, contractor, finding an investor . You're closing, where your investor actually comes into the deal and your lender.

Then you go out and construct, then you have lease up, initial lease up, I should say, and permanent financing. So those are kind of these five phases before you actually operate the property. Generally your cost certification is going to start after construction and before permanent financing, because it's going to trigger the equity infusion that will help lead to permanent financing.

So there, that's when it'll take place and it's submitted to the state allocating agency. Every state has one and it's submitted there and it's also, you know, delivered or submitted to your investor for approval. Sometimes lenders might want to see it as well. But the investors and the state agency are the key players that will look and review that, provide comments and ask questions about that document.

[00:08:08] Michael Novogradac, CPA: And in terms of the completion of the cost certification, when it's completed and submitted to the state, how often do the, equity investors upon completion of the cost certification, but before and upon submission of the state, but before the state actually issues the IRS Forms 8609s, how often do investors give a capital contribution based upon completing the cost certification? And how often do they give an additional equity contribution when they get the 8609s in the transactions that you work on, would you say just roughly?

[00:08:41] Warren Sebra, CPA: Yeah, I mean, I think those are two key benchmarks. Sometimes they're separate, sometimes together, but I find that they're separate and, you know, there could be, hey, upon receiving the final cost certification to get another tick of the equity and then 8609s, another infusion of capital. I think that's important to recognize that there could be two separate benchmarks there, even though they kind of are talked about together. Oftentimes they're separated cause they want to encourage the developer to get those things done because it's important for their credits deliver to have those 8609s. The final cost certification is not the end all, be all. You have to receive those 8609s.

This is going to get into the bit of the weeds, and this is basics , but one issue that you know has always been around ever since the cost certification requirements, were in, effect is a state agency oftentimes wants to know what the permanent financing's going to be so that they know they can judge whether the maximum amount of permanent financing has been obtained because they don't want there to be too much cash flow. They want properties to have enough cash flow to deal with potential headwinds over time, but they don't want the property to have too much in the way of cash flow.

[00:09:53] Michael Novogradac, CPA: Because if there could be more permanent financing, then that could cause the state to not allocate as much tax credits so they then could allocate the credits to others and create more housing in their state. So there ends up being this tension between the permanent lender not wanting the loan until the final equity contributions are in place to fund the gap and the permanent lender not wanting to lend until the 8609s are done. But the state agency wanting to see what the permanent financing's going to be before they issue the 8609s. What's been your experience, on that front? And it's a relatively a technical area, so maybe you just want to punt to a future podcast.

[00:10:31] Warren Sebra, CPA: It is relatively technical and it's, and I would say some states interpret are, do things differently. So it's really important to kind of understand your state processes. I know a lot of states are really concerned about, you know, matching up permanent financing and making sure it's accurate as possible. Whereas in reality, sometimes you don't know quite know what it's going to be, and it's a matter of submitting that correctly to the state so they can understand because it could be a key issue. And I, especially, a lot of times some of my developers I work with, they don't submit until financing has been secured just because they know the state is looking for that key indicator and they want to know what it is exactly. And so some of my developers have-- do wait to that time and that's key to understand. Know your states.

[00:11:17] Michael Novogradac, CPA: That's certainly one of the themes here is you definitely need to know the rules at the federal level, but you also have to know the rules at the state and we interchangeably say state or credit allocating agency because there are some cities, two cities that are their own allocating agency. But we won't get into all of those details, but just we oftentimes say state, but we conceptually mean credit allocating agency, but most of them are states and then of course there are possessions. But now I'm going off on tangents.

[00:11:48] Warren Sebra, CPA: Excellent point, Mike.

[00:11:49] Michael Novogradac, CPA: So to provide context for our listeners, maybe you could describe the role of the accountant. You're obviously an accountant and a CPA, and perform lots of final cost certifications. What is the role of the accountant with respect to a final cost certification?

[00:12:04] Warren Sebra, CPA: Yeah, you know, the key role is to be an auditor, right?

We're auditing these costs and delivering an opinion on that, that state and investors and the developer are relying upon. So that's our key thing. But we also are there to help assist the developer know what we're doing and why we're doing this cost certification, and why are we moving things in eligible basis and tax or tax credit basis.

And that's kind of what I see often people know what an audit is, but in relation to how we're taking the cost and then also taking the cost of the developer, calculating an eligible basis. And that is where I like to assist my developer clients in helping them understand what eligible basis is and how we get there and how important that is to be accurate and have good records to help us get to the correct answer.

And from there then it becomes a product that, you know, the developers can use and we can go on and switch to the state and send it to an investor.

[00:13:04] Michael Novogradac, CPA: So what are the general responsibilities of the developer in ensuring that the final cost certifications are done as efficiently as possible?

[00:13:13] Warren Sebra, CPA: Great. The first thing is hire a CPA, right? We talked about what our role is, and I think you want to think about that at, you know, closing and certainly so they could have some consistency and have your CPA look at maybe your financial forecast and give some kind of consulting on, hey, do this or that. Because when you close, your investor's going to do a forecast and they're going to estimate eligible basis.

And you wanted to be able to know that, hey, when you go do the cost cert, that it's going to be consistently interpreted by your CPA and understand where the key points are in calculating eligible basis. So that's one thing, hiring a CPA. And also keeping accurate records. And that really enhances the a location process and speeds up the process so the CPA can deliver a product in timely manner for the benefit of the project.

[00:14:00] Michael Novogradac, CPA: So with that in mind, and you know, obviously I have my recommendation, but what's your recommendation as to what point in the planning or development process that advisers should start thinking about the cost certification?

[00:14:14] Warren Sebra, CPA: There's a, the thing that we hear a lot oftentimes in, in business, you know, I think Stephen Covey may be the first one who talked about it, but beginning with the end of mind is, I think, is a key concept with this cost certification and with your LIHTC development, you want to understand the process and where you're trying to get to.

And if you are closing an affordable housing project with an investor, and you haven't thought about the cost cert in a year and a half to two years, you're going to be in a world of trouble because you're not going to deliver in a timely manner because you have to keep records and invoices and schedules to help your accountants perform the audit correctly to give that opinion.

And so if you're not worried about that, when you start disclosing and beginning construction, your records aren't going to be accurate or they'll be disorganized. And delivering that to your CPAs for their audit review is going to be, it's going to be difficult, so you should be thinking about it the day you start your pre-development and keeping accurate records and so you can deliver those cost certs when needed.

[00:15:12] Michael Novogradac, CPA: And in terms of different categories, you would say on the one hand, make sure a lot of work is done in estimating tax credit basis so you're capturing as much of it as you can and then ensure that you're, in the course of the development, retaining records that are more readily auditable. So that's all great tips.

[00:15:36] Warren Sebra, CPA: And I also just would, a quick tip, Mike, is I see a lot of people being very aggressive at the forecasting phase with eligible basis. And that could put you in a world of hurt because when you do the cost cert, if it's off from your estimates, that means you're getting less equity from your investors. So it's important to understand when you can increase the eligible basis during the forecasting, because that affects what the projected equity is.

[00:16:02] Michael Novogradac, CPA: That's good advice, good caveat. So I touched on this a little bit in my introduction, and it's obviously a situation every developer wants to avoid, but could you explain in a bit more detail, you know, what can happen if a final cost certification is not completed and submitted on a timely basis?

[00:16:20] Warren Sebra, CPA: Yeah, absolutely. And we hinted about this in one of the first two questions about benchmarks. So your limited-partner agreement, it's going to list out four or five, maybe seven or 10 benchmarks you need to hit to receive your equity. And if your cost cert is one of those benchmarks, it becomes a timing issue, right, when you deliver that.

And if your records are not adequate and you deliver those in a disorganized manner to your CPA, it's going to be very challenging for the CPA to unravel that and deliver on time. And there's going to be some delays that could be detrimental to delivering that cost cert because you're trying to get to perm closing, right?

If you're delaying perm closing, you could have extension fees or increase your cost and then, you know, increase interest costs because construction interest is generally higher than permanent loan interest. And so you want to get to that point and save your project money by delivering that cost cert on time.

Because, remember, the cost is going to be the key to deliver those 8609s and the 8609s are going to be a golden ticket for claiming those credits.

Examples of Eligible Costs

[00:17:23] Michael Novogradac, CPA: All good points. And I would just layer on that when you're negotiating with an investor for capital contributions, you definitely want to work with the investor to give you a capital contribution when the cost certification is done.

I say that because some states can be a bit delayed in processing 8609s, and when you're waiting on a large capital contribution and your state's getting delayed, it can be very frustrating and obviously every day that goes by that you don't get direct contribution is a day more of interest expense.

And when interest, interest rates were really low, it wasn't maybe as much of an adverse effect, but with higher interest rates, the delay in getting the 8609s from a state can have an adverse effect on a development, particularly when a large equity contribution is contingent on that. So let's move on to additional cost certification basics.

So we know getting it, getting a cost certification done correctly in a timely manner is very important. I want to talk now about some examples of eligible and ineligible costs. I'm going to say eligible, I mean eligible to be included in tax credit basis and ineligible, meaning they're not eligible to be included in tax credit basis.

And I will also note, as a general caveat with respect to this, you know, many transactions are using allocated or 9% credits get, they'll get a set credit amount award, and if their cost in their tax credit basis ends up rising above that number, they generally won't get more tax credits. Now, there are situations that we've faced with cost overruns and the rest where there are substantial higher costs and they get a supplement allocation and all the rest.

So it's not unheard of, but it definitely is a general rule you don't get additional credits if your eligible basis exceeds the minimum level for qualifying for the full amount of your award. If it's a 9% allocated credits, there might be other reasons why you want to have additional costs, but we'll save that for a 202 on another podcast.

But with respect to bond transactions, and that would be the credits that come along with financing 50% of your land and building with private-activity bonds, they're, generally speaking, every dollar of additional tax credit basis does turn into additional tax credits. So with that, it's just a general, maybe level setting for the newer listeners.

I also wanted to note that the IRS provides guidance as to what's includable in eligible basis. So we have this discussion about examples of what's ineligible and ineligible costs. Ultimately, the IRS ends up providing guidance. If you disagree with the IRS, you can go to court, but nobody goes to court and disagrees with the IRS.

[00:20:11] Michael Novogradac, CPA: There's a default. The IRS guidance that is out there is generally what investors will use in terms of what's included in eligible basis. That said, many allocating agencies have rules or procedures that limit what can be included in tax credit basis for groups of them awarding credits. So you basically, it means that on a given development, you have to look at what the tax credit basis is from the IRS's perspective and what the state will award on, and it's a lesser of those two. So you have to, you know, it's the least-common denominator. So that was a bit of a lengthy introduction to a question. So I apologize, Warren, I apologize for our listeners, but I did want to do a bit of level setting as we start to talk about, you know, cost being included and not being included.

So let's start with some examples of costs that do generally speaking get included in a cost certification or do get, I shouldn't say included in a cost certification because all costs are included in cost certification. It's the costs that are included in tax credit basis, as part of a cost certification.

[00:21:18] Warren Sebra, CPA: Right, Mike. Thanks for clarifying that because each state will have a form, right? And some states are more particular about what form they use. So I haven't mentioned that. I just want to mention that. Make sure you know what form you use because it'd be very frustrating to, to deliver a form to the state and it's be the incorrect form, so make sure you're using the correct form.

But there will always be a column for total construction cost and a column for eligible basis. And so we're talking about that column for eligible basis or you know, tax credit basis. And so a lot of things that are included, it's, I like to look at this as the code is kind of designed to capitalize more and expense less. And for LIHTC developers, that's great. So there's a lot of ways to capitalize your cost, meaning including in eligible basis. And so hard costs or cost of construction like a contractor cost, the cost to build it are included in eligible basis, direct soft costs like architecture, engineering, including eligible basis. Soft costs also during construction are included during eligible basis. Soft costs include interest, insurance, taxes, amortization of loan fees, things like that, that are kind of indirect. Soft costs are included in an eligible basis. There are obviously some very nuanced things to think about when you're determining eligible basis.

You know, that could be for a podcast 202 right? So it's important to kind of you know, if you have issues in your project, you're not sure what should include an eligible basis to, you know, contact your adviser, to get your accountants. So you kind understand there, because there's a lot of nuances.

But those are the key things that I look at for include eligible basis, hard cost, direct soft cost, and direct soft cost.

[00:22:54] Michael Novogradac, CPA: And kind of broadly speaking, when we think about the hard costs, we're thinking about costs that are depreciable.

[00:23:00] Warren Sebra, CPA: Right.

[00:23:00] Michael Novogradac, CPA: As a kind of, like the initial sort of bright line test in terms of costs that end up getting included. So depreciable costs are, or the bright line test of costs that get included. So what are some examples of costs that generally are not included in tax credit basis?

[00:23:19] Warren Sebra, CPA: Right. Or costs that are generally not depreciable. Right?

[00:23:22] Michael Novogradac, CPA: Right.

[00:23:23] Warren Sebra, CPA: That's where you start with, right? So costs that are not depreciable. the obvious one that I always point out is land.

So your land costs are not included. It's a key thing to remember that your acquisition cost oftentimes can be. So when you're acquiring a property in an acq/rehab, land, not eligible basis, acquisition, can be in your depreciable basis and can be included in eligible basis at times. Most of the times it is. So land. Well, think of land, you know, there's, you say, well, what's, what is land? Land is what you pay for the land. And also cost to improve the land. That can be a little murky sometimes, especially with your remediation. And I look at it as if you're improving the land, then this actually costs to land out to the building.

[00:24:07] Warren Sebra, CPA: And I remember real quick, Mike, a story I had doing one of my first cost certs when I was a staff accountant looking through all the invoices, not understand what was going on and reading them. And the line items said, removal of human remains. And I said, what am I looking at here? And it turned out that what it was, unbeknownst to the developer, they had started developing on a Native site, Native American site, and they had to remove those human remains to a different location. And we had quite the debate of where these should be. And in the day with the council of, you know, the code and the developer, we decided, hey, that's really improvement in land. And because whatever building you'll put on that you would have to have taken care of the, those things if you want to build that property.

That's kind of how I look at it with land, is if you're, if you have to do it to any building that goes on top of that land, oftentimes it's a land improvement and those don't get included in eligible basis. That could be a very significant cost, especially in your in states on the east and west coast where land value is very significant and so that all those costs are not, would not be included in basis.

Other small costs like commercial cost. If you have a commercial space in your building, those costs would have to be allocated out of eligible basis. And things like reserves that are in your capital stack, operating replacement reserves, any debt service reserves, and you know, you don't think of those as construction costs, but they're going to be a cost of the development because they're going to be financed by permanent sources.

So that's why you'll see reserves on your cost cert because states want to see. What your permanent sources are going to cover, and those reserves will be funded by your equity contributions or from your, from your lender.

[00:25:45] Michael Novogradac, CPA: Now, thank you for that overview. And I like to think of it as you've got the buckets of costs that are easily determined.

You know, land, you know, the wood for the framing and things of that nature that, or I should say wood for the framing of the units that are going to be used by the tenants. But you have the first layer of cost. Then you have a lot of soft cost you have to then get reallocated among various qualifying and nonqualifying categories.

So there's definitely a lot more tiering that goes on the course of the cost certification process. That's once again, above and beyond the purposes of this podcast. I did want to cycle back for a moment to deal with the fact that tax credit properties, one of the benefits of the low-income housing tax credit is that developers can readily layer in other tax credits and or government debt financing. For example, many rehab low-income housing tax credit properties also qualify for historic tax credits and regarding government debt financing, many tax credit developments also receive financing from the Department of Housing and Urban Development or HUD.

These additional sources often have cost certification requirements as well. So could you discuss some of the situations where additional financing sources necessitate additional cost certifications and how that gets layered in the timing of preparing the cost certification that'll be submitted to the state housing agency?

[00:27:10] Warren Sebra, CPA: Absolutely. And you know, right now I'm working on a few projects that are, we call a twin deal, meaning that you're using two different credits, historic tax credits and low-income housing tax credits. And it's important to, just to make, to clarify one thing is on LIHTC side that the cost cert has been submitted to the state. An historic tax credit cost cert oftentimes it's not submitted to a state agency. More often not, it's not, it's more submitted to an investor, but your investor is invested in historics and LIHTC and so they may require a cost cert for both. So it's important to figure out what schedule you're going to use and because for the state housing agency, they're not really concerned about the certification of the historics. They want to see it in the calculation of permanent finance and construction financing. But in terms of it being there and certed by the CPA that they're not concerned about that. So you have to come up with a form that's going to correctly deliver a product to your investor that it will, they will be sufficient for an investor. So oftentimes you might have supplemental schedules or included in part of the LIHTC cost certification. Sometimes investors might have you do two separate ones, separate LIHTC and separate historic cost certification. So it's important to kind of understand that and know what you're dealing with when you deal with a cost certification on a twin historic LIHTC deal.

With HUD, oftentimes HUD has what's called a mortgages cost cert. But, with LIHTC, there's an exception. If you have a LIHTC property, oftentimes you can waive out of that, that certification and that final cost certification. You may have some other things called a contractor certification that you have to do if you're a related-party contractor doing a HUD project.

[00:28:50] Warren Sebra, CPA: So it's important to say, hey, do you have a HUD project? Do I have this cost certification requirement for LIHTC? Probably not, but you may have some other requirements to submit to HUD if you're a related-party contractor. So be careful that some states also might require a special mortgage cost certification.

Be careful of your state requirements because there are some that require, and it could be quite cumbersome to figure out what they require, but they do require, so be mindful of that as well.

[00:29:16] Michael Novogradac, CPA: So thank you for that. There's a lot more we could talk about there.

[00:29:20] Warren Sebra, CPA: Oh yeah.

Ways to Enhance Eligible Basis

[00:29:20] Michael Novogradac, CPA: But we'll, we'll keep moving here. OK. So there are some ways to enhance eligible basis that many listeners may not be aware of. And ideally, a developer incorporates these approaches at the very beginning of development. In that way, they can include as much of the additional tax credits that they'll ultimately eligible for in the associate equity financing in their initial budget, initial forecasting. With that said, could you share a couple of the ways that developers can increase tax credit basis that are less a function of classification of costs, but more a function of accounting methodology in the ways in which Section 42 operates?

[00:29:59] Warren Sebra, CPA: Yeah, and real quick, I just want to mention. You know, a DDA and QCT, because those are, that is a 30% basis boost. And so that happens at the planning stage, meaning the location of your project could give you a 30% boost. A lot of developers know about that. I just want to mention that's a way to boost your project. A lot of projects do qualify for that.

So keep in mind the 130% boost could enhance your eligible basis. But on the technical accounting side, I think you look at what's called a tack back rule, and this would apply for acq-rehab projects where you're allowed to start taking, and it's important to realize your acquisition and your rehab credits are taken concurrently in the same year.

So you may acquire your property a year or so before you complete your rehab, but what the tack back rule allows you to, on a certain circumstance and following some technical rules, and we won't get into the minutia of that, but if you follow the rules, you can go back to the day you acquire your property, start claiming eligible basis.

So for example, if your rehab was done, completed in November of 2022, but you purchased a property in May of 2021, in theory, it's possible. If you have lease up and you have tenants that are in the project, you could start claiming your credits in January of 2022. So that's one rule that you really have to be aware of when you're doing the acquisition rehab project.

It's quite complicated because it involves keeping track of the units that are leased up and sometimes, when you are doing an acq-rehab, there's tenants moving in and out of units and changing units. So it takes a lot of planning consideration to make sure you are doing the best way to enhance your credit delivery to your investor, and as we talked about before, if you have, you know, increase eligible basis delivered, you get more equity and that capital infusion can really be a benefit to the project. And, another would be 263 A, the avoided cost where you can make an election to take your operating cost and capitalize it to basis and therefore include in eligible basis. So those are kind of the two other factors. Just curious, Mike, do you know of any other things?

[00:32:07] Michael Novogradac, CPA: Well, there's, I think those two are probably enough for our listeners at least to whet their appetite.

[00:32:12] Warren Sebra, CPA: Okay.

Tips and Recommended Practices

[00:32:13] Michael Novogradac, CPA: And I just would say that, you know, rather than talk about some additional methodologies or different, additional ways in which credit basis could be enhanced or tax credits could be enhanced, I'd probably just emphasize the fact that this is something you do want to include in your original projection. Because like when you mentioned the tack back rule and the ability to start claiming credits earlier in the year, that will lead to a lot more credits in the first year of the 10-year, really 10-year-plus-spill-over-credits, year-11 credit stream.

And you want to ensure that your investor sees that schedule because they'll end up being able to pay a slightly higher equity price. And then similarly on this avoided cost capitalization rule, the substituted cost rule that can increase tax credit basis. You want to get that in to the initial estimates. So once again, you're projecting a higher tax credit basis, and then you're, when you apply for the state for credits, you can potentially qualify initially for more credits and get your investor to commit to buy the additional credits at the beginning.

So let's, now move on to more of our sort of tips and recommended practices portion of the topic. There's a lot of tips I know that you have for developers with respect to cost certifications. But maybe you could just share a couple that you would think, okay, this is something that if I can only name one, two, or three top cost certification tips, this is what they would be.

[00:33:40] Warren Sebra, CPA: Yeah. And this one tip that I have, it's based upon many years of experience. Oftentimes you'll see in the accounting department, they'll have an accountant over development and accountant over, you know, operations and development, the person over accounting development might be the developer themselves and to keep a schedule of all the development, but it won't be recorded in the general ledger during that time.

And then they'll record all the adjustments, you know, two years after the development. What that leads to is this confusion, meaning that is like, okay, what was this transaction that happened, you know, 18 months ago? So I think the tip is to kind of-- it's okay to have your development on a spreadsheet. A lot of developers use that to keep track of each draw.

That's perfectly fine, but to find a way to have that include in the general ledger and record it correctly. So in sometimes at a cost certification, it's clear what took place cause the transaction that happened. You just might not remember, you know, 18, two years ago when you started the cost cert.

That's one tip is to try to merge that into a general ledger as soon as possible. Sometimes it's more difficult than it can be, but it's worth it if you're trying to deliver that cost on time. Also another tip is, it's kind of self-serving, but I think it's important is to keep your accountants up to date on the project.

And if there are transactions that occur, especially at the closing, that are quite unusual, that might need some clarification on the accounting side, because oftentimes you'll see it's not told to the accountant, and then when it comes to record at the cost certification time, there's things that might need to be explained and changed where it was, that wasn't the situation back in two years ago.

So I think letting your accountant know about those unique transactions before the cost certification is also key point.

[00:35:24] Michael Novogradac, CPA: So I don't like talking about negative things, but I will break that rule when talking about negative things. We'll avoid negative things, so maybe you could discuss some common pitfalls for developers so those listening can learn from others and learn vicariously as opposed to learning from their own personal experience.

[00:35:44] Warren Sebra, CPA: Yeah, and I think a common pitfall is if you're an experienced developer and you're jumping into like development, you may have an accountant you've used often and you need to make sure that accountant is experienced because it could be a quite hard thing to, to learn at first and an experienced accountant doing cost certs is really important because it's a very unique niche and to have someone experienced is really important.

But also, you know, the, I think the pitfalls is what I talked about in the earlier thing, tips is having, not having adequate records because remember this is going to be an audit process and so you need to deliver a quality documentation to your accountants so they can efficiently do the audit.

[00:36:27] Warren Sebra, CPA: And if it's not delivered in an efficient way, it can lead to delays in that delivery of the cost cert. So that's what I would say is back to my original thing, is having adequate records kept so you can deliver it to your CPA and they can get started as soon as possible.

[00:36:46] Michael Novogradac, CPA: And I, I would just build on that by emphasizing your point about working with experienced CPAs.

Just like we say, you should work with an experienced attorney who's experienced with low-income housing tax credits. If it was tax-exempt bond financing too, then an attorney that's experienced with both, not just one of the two, and then your attorney should be, your accountant should be, but it also go beyond saying an accountant should be experienced with the low-income housing tax credit, they also should be experienced with the state rules for the low-income housing tax credit. Because as you discussed, there's a number of idiosyncrasies that states have, for a variety of good reasons. But they are idiosyncrasies and they are different. And the more parties you have who are experienced in the state, the less likely you are to, you know, to, to hit a roadblock.

And I'm not saying you won't hit a bump in the road because states are changing the rules and all the rest. But if you have a number of experienced parties involved, then you're less, you're going to anticipate a lot more of those road bumps. And when you do face them, you'll be better situated to be able to strategize, to get around them or over them.

So it, it's definitely something where experience pays lots of dividends.

[00:38:02] Warren Sebra, CPA: Excellent point about the states. Well said.

[00:38:05] Michael Novogradac, CPA: So thank you for that, warren. Before we close, I wonder if there's anything else that we haven't covered that you thought would be important to add.

[00:38:14] Warren Sebra, CPA: Wow. You know, like we said, we can definitely do a 202 class. I think it's really important to understand what a cost cert is, figure out what eligible basis is. It's really important. Nothing specific, but just keep in mind that this is a process that is not easy the first time around, but once you do one, two , three or four, it becomes easier and more understanding and knowledge is gained.

[00:38:39] Michael Novogradac, CPA: So thank you for that. Anything else you wanted to share before I bring the podcast to a close? You can't leave though. I do have questions to ask you.

[00:38:49] Warren Sebra, CPA: But yeah, sure. No, I'm not going to leave. Yes, I think, you know, in two weeks we're all going to be in, in Las Vegas and we're going to be attending the tax credit housing finance conference, which is December 1st to the 2nd, and there'll be plenty of discussions on eligible basis, final cost certifications you know, networking between developers and you know, investors, stuff like that. And also a personal plug. I'll be doing a workshop on November 30th about running the numbers, which is before the actual forecast. So if you like to join me with that, I'd love to have you and we will go over model, an affordable housing transaction and go in a deep dive how to calculate tax credits and how to calculate eligible basis and specifically how it relates to under underwriting process.

Exit

[00:39:34] Michael Novogradac, CPA: Great. Thank you Warren. I will link to the conference in our show notes and I do encourage listeners to contact Warren directly with any questions about their specific developments. I'll include Warren's contact information in today's show notes as well, which can be found at www.novoco.com/podcast.

Next week's episode is slated to continue our "So You Want to Be a LIHTC Developer" series with an installment about operating expenses and income. Two members of Novogradac's valuation team, Blair Kincer and Kelly Gorman, will be my guests. Blair is a partner in our Washington, D.C., office and he specializes in market analysis and appraisal of various types of mixed-income and affordable housing.

[00:40:15] Michael Novogradac, CPA: Kelly is a principal in our New Jersey office and has extensive experience performing appraisals, market studies, rent comparability, studies and consulting services for a broad cross section of clients in the low-income housing tax credit and supportive housing industries, including developers, lenders, syndicators, property managers, and state agencies.

They're going to help us better understand operating expenses and income. And this is the results of a survey that we do every year, if you're familiar with our operating expense and income report. And every year I'm always interested in seeing the results of the survey and seeing how operating expenses have been trending, both on a year-to-year basis, but more importantly over a five-to-10 year basis.

And then similarly, I'm always interested in seeing how income is changing on a year-to-year basis, as well as over a five-to-10 year basis. This has been particularly useful in the, during this COVID period where we've been trying to identify what the impact of COVID has been on both operating expenses and operating income.

And then of course, as we reach a more inflationary environment, how inflation weaves its way through operating expenses as well as shifts median incomes and allowable rents. So there's going to be lots for us to talk about, and I do hope that you'll join us. You can make sure that you're notified of next week's episode in each week's episode by following or subscribing to the Tax Credit Tuesday podcast.

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Off-Mike

[00:42:02] Michael Novogradac, CPA: Now we reach our Off-Mike section where I am able to ask our guests some off-topic questions to get some off-topic advice and words of wisdom from our guests.

So, oh, so Warren, one of my favorite questions for podcast guests, and I presume I've not asked you this before, what is your favorite podcast? And it goes without saying, you cannot say Tax Credit Tuesday.

[00:42:30] Warren Sebra, CPA: Okay. Well, in, in baseball season, I have several, but that's a very specific niche.

Baseball season is over now, but the daily podcast I listen to quite often is, it's called The Journal. It's from the Wall Street Journal and it's a 10-15 minute news story and it's perfect because my commute to and from the office is 15 minutes and so I can just get a quick little synopsis.

It's not the news of the day. It's just one little story or news story that they go over and it's quite interesting. It's generally about topics I probably want to read about, and so it's good to kind of get that little bit of a new story.

[00:43:03] Michael Novogradac, CPA: And it's roughly 10 or 15 minutes on one topic?

[00:43:06] Warren Sebra, CPA: Yeah.

[00:43:08] Michael Novogradac, CPA: I really like that. Is there a recent topic that comes to mind that you found interesting?

[00:43:12] Warren Sebra, CPA: Yes. As you know, I'm in Portland, Oregon, and the headquarters of Nike are here. And so there's a lot of sneakerheads that are around and they recently did a podcast about, fraud, which is interesting to me as an auditor, about this sneaker industry and how you know, Nike will sell, you know, 50 shoes in one day and people will buy and then resell. So about the resale market and fraud that happened in the resale market, with some sneaker shoes, that was interesting to me.

Interesting indeed. So, another question that as someone who travels a lot, I love asking guests so I can learn and put them to use myself. So this is, you know, a question that oftentimes I get tips that are really helpful for me personally. With next month's tax credit housing conference in mind, is there a travel tip that you'd like to pass along to our listeners?

[00:44:00] Warren Sebra, CPA: Yeah, I thought about this a lot. Like what trip, what tips did I have found, and I think one that I have done last six to eight months is to use taxis when I'm at the airport. And the reason why is I have found that with the ride-sharing programs, oftentimes they're more expensive from the airport. Obviously ride-share apps are very useful for a lot of different reasons, but from to and from the airport, I have found that taxis are one, more efficient in your time. And also oftentimes the same price or cheaper than the ride-share apps that are out there because one of advantage of the taxis is you get outta the airport, they're all lined up. Whereas an Uber, Lyft, you have to call them, they say, hey, it takes two minutes, when in reality it's 10 minutes.

So I've gone back to my taxi use, especially in the airports when I'm traveling. But I'm curious, Mike, you're a prolific traveler, more so than anyone I know. What are some of your travel tips that I can apply to my routine?

[00:44:54] Michael Novogradac, CPA: I'll start by saying I do like your point about the taxis, because I, as you mentioned now, with the way in which ride sharings work in the rest and the extensive use of ride sharing led to a decrease in demand for taxis.

So now I suspect that your average wait time for taxis has dropped sort of dramatically. So that's something I'm going to have to be, think a little bit more about in terms of my traveling. So I'll definitely, you know, put that tip to mind. But, you know, for me the sort of number one travel tip really isn't a travel hack or anything.

It's more just, you know, when you get to the airport, be prepared to be late, be prepared to deal with delays, be prepared for lines and all the rest. And, you know, I like to say pack your patience. And you know, for years of traveling, I wasn't the best at packing my patience. And then there was one trip that I had where I ended up-- and this couldn't even happen today. This was back when airlines could do things like this and it wasn't, you know, people didn't object quite as much where I ended up flying to San Antonio and the plane got diverted because of thunderstorms to Austin. And we got to Austin at like 1or 2 in the morning.

We stayed on the plane until 4 or 5 in the morning or something, and then we flew on to San Antonio. So we never got off the plane in Austin. And I got to San Antonio and it was, you know, was, you know, was the morning and then I got to the hotel and I couldn't check in yet, and I went and spoke at the conference I was there to speak at.

So, needless to say I was tired by the end of the day, but it was just at some time during the night sitting in the airplane in Austin, I sort of came to grips with the fact that I just had to kind of go with the flow. And ever since then I've made sure to pack, you know, number, to basically pack to be able to deal with delays and be functional.

So now I, you know, wherever I am, really, your office is with you. So I'm able just to go and not be so focused on, are you on schedule, are you not? It's more, you know, I'm here and available, so when you're ready for me, I'll get on the plane. When the plane's ready to take off, I'll be ready and not be too focused on.

Is there delays or not a delay? And just be a little more mindful and as a consequence, use the time more effectively. So it's not really a hack. It's really an approach. It's a mental outlook for travel, but it's definitely one that has done me very well. And as a consequence, the travel can be a lot more productive and more enjoyable.

[00:47:23] Warren Sebra, CPA: Yeah, that's a great approach, Mike. Great approach.

[00:47:26] Michael Novogradac, CPA: So thank you for that. And thank you again, Warren, for joining. And once again, to our listeners, Warren's email will be in our show notes, so please feel free to reach out to him. And also to our listeners, I'm Mike Novogradac. Thanks for listening.

Additional Resources

Email

Warren Sebra

Previous LIHTC Basics Podcasts

Nov. 1, 2022: Financial Feasibility and Market Considerations

May 10, 2022: Comparing 4% LIHTCs and 9% LIHTCs

Oct. 5, 2021: LIHTC Basics

Conference

Novogradac 2022 Tax Credit Housing Finance Conference