SOUTHERN VIRGINIA REGIONAL HOUSING SUMMIT : FINANCING OPTIONS – TAX CREDITS

BRIAN WISHNEFF & ASSOCIATES

ABOUT US

Brian Wishneff & Associates

- Since 1995, BW&A has worked on over 200 Historic, Low-Income Housing, New Markets, and Solar Tax Credit projects across 36 states and DC (30 housing projects in Virginia alone).
- BW&A helps facilitate a broad range of projects including multi-family housing using tax credits and other incentives.
- We have facilitated over $4 billion in investment resulting in over $800 million in tax credits.
- In addition to helping to facilitate tax credit projects, BW&A is also undertakes its own real estate development.

OPPORTUNITIES IN VIRGINIA

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- Federal Historic Tax Credits
  - 20% Tax Credit
- Virginia State Historic Tax Credits
  - 25% Tax Credit
- Federal Low-Income Housing Tax Credits
  - Either a 4% credit (4% annually for 10 years) or 9% (9% annually for 10 years)
- VA Housing Opportunity Tax Credits
  - Equal to the Federal LIHTC
  - New Program - Statewide credit cap.   Program rules are still being finalized.
- New Markets Tax Credits
  - 39% competitive credit that may be available for certain mixed-use projects

FEDERAL HISTORIC TAX CREDITS

- 20% of Qualified Rehabilitation Expenditures (QRE) – claimed over 5 years
- QRE includes renovation and associated soft costs. Does not include acquisition, site work, furniture, and anything not permanently affixed.
- Must spend at least 50% of assessed value, and development costs must exceed acquisition cost.
- HTCs can be monetized with a third-party investor if developer cannot efficiently claim the credits.
- Rehabilitation must be certified for compliance with the Secretary's Standards for Rehabilitation subject by a 3-part review by National Park Service.
  - Part I Application – Confirmation that the building is designated historic
  - Part II Application – Rehabilitation plans must be reviewed and certified for compliance with the Secretary's Standards for Rehabilitation.
  - Part III Application – The project must submit photos documenting that the project followed the approved plans.

VA HISTORIC TAX CREDITS

- The VA HTC is a state incentive promoting urban and rural revitalization through private investment in reusing historic buildings. In general, it is similar to the Fed HTC and can be used in combination with the Federal program.
- 25% of QRE
- Like the Federal program, the credits are generated by the entity owning the costs to rehabilitate a historic building.
- The VA HTCs can be monetized with a third-party investor that may be different than the Federal HTC investor.

PRACTICAL HTC CONSIDERATIONS

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- Is the building being considered a good candidate to be converted into housing?
- Can the project sponsor use the credits efficiently without bringing in an investor?
- Is your project large enough to monetize HTCs?
- Factor in the timing of when tax credit equity will be available – bridge financing required?
- The VA HTCs can be monetized with a third-party investor that may be different than the Federal HTC investor.

LOW INCOME HOUSING TAX CREDITS

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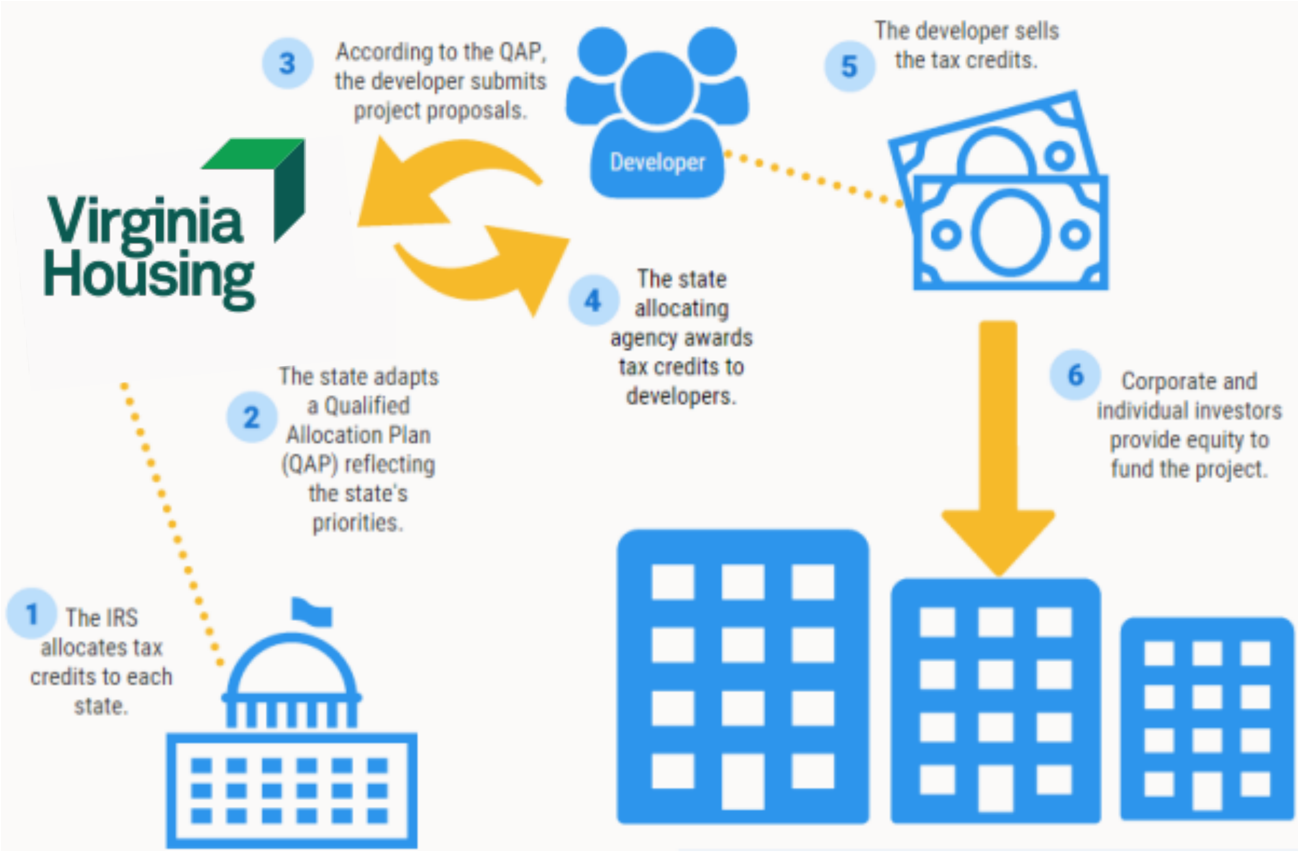
- The IRS allocates tax credits to state housing agencies based on each state's population, which are used to finance projects through this process (right).
- Project sponsors must set aside at least 40% of units for renters earning no more than 60% of the area's median income (the 40/60 test) or 20% of units for renters earning 50% or less (the 20/50 test).
- State selection procedures for tax credit allocations often encourage sponsors to provide more than the minimum number of affordable units and greater than the minimum level of affordability.
- You only get LIHTCs for expenditures related to the affordable housing component of a project.



LOW INCOME HOUSING TAX CREDITS

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- The LIHTC is calculated as a percentage of costs incurred in developing an affordable housing property, and is claimed annually over a 10-year period.
- Eligible Costs include many that are not HTC qualified, sometimes including building acquisition. However, costs associated with commercial space within a building are not LIHTC eligible.
- The qualified basis equals the fraction of the cost of the housing project rented to tenants meeting the income tests.
- Credits are allocated over a 10 year span, and owners must pass income and rent tests for a 15-year compliance period, during which the IRS may recapture previously claimed credits.

4% VS. 9% CREDIT

- There are two LIHTCs. Credits can provide the present value of either 30% of eligible costs (the “4%” credit) or 70% of eligible costs (the “9% credit”).
- 9% Credit
  - <u>Highly</u> competitive.
  - Virginia Housing has an established process for awarding these tax credits on an annual basis.
- 4% Credit (recently fixed at 40% of basis)
  - Must be used in conjunction with tax-exempt bonds
  - Projects financed by tax-exempt bonds do not need to obtain an allocation from the state housing finance authority, though the state must approve the use of these bonds.
  - If an existing building, it cannot have been placed in service within the last 10 years

VIRGINIA HOUSING OPPORTUNITY TAX CREDIT

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- New program approved in 2021 by the legislature.
- Credit is equal to the Federal LIHTCs generated by a project and can be used in conjunction with the Federal LIHTC program
- $60 million annual cap on credits awarded.
- $20 million of the total credits are specifically set aside for communications with populations of less than 35,000
- Final rules are still being drafted.

THINGS TO CONSIDER - LIHTC

- It is most efficient to identify investment opportunities with these programs in mind upfront. It is much easier to locate properties that are good fits and plan for these credits accordingly, rather than retroactively working to change a project to fit these programs.
- For example, location is key, as it can impact the total LIHTC subsidy you are eligible for (% boosts in certain areas).
- It is helpful to work with lenders that are experienced with the program you are working with. Fortunately many lenders in Virginia have tax credit experience.
- Project sponsor does have some discretion as to how tax credit equity is use. The 40% LIHTC credit is a considerable subsidy, but adds significant restrictions to a project. For example, LIHTCs are only generated as units are occupied by qualified renters, and must remain occupied by qualified renters throughout the LIHTC compliance period.
- For this reason, qualified property management is a critical component of LIHTC deals.

MONETIZING TAX CREDITS

- Tax credit investor(s) may be admitted into a project partnership. They may be allocated certain tax credits generated by the project.
- Projects may have multiple investors but it is typical that one investor takes all Federal credits and one investor takes all Virginia credits.
- In exchange for the tax credits, Tax Credit Investors make an equity investment into a Limited Liability Company owning the property and incurring the qualified expenses which produces each credit.
- The Tax Credits will typically provide the majority of the economic return expected by the investor but they also may receive some ancillary tax benefits and cash returns.
- While the tax credit investor is a partner in the project, typically there oversight and rights as a partner are limited so that the project sponsor maintains control.
- The Tax Credit Structure must remain intact at least as long as each program’s compliance period.

TIMING

1. Position project to secure HTCs and LIHTCs

- Develop and implement ideal financial and legal structuring to secure maximum benefit from the use of tax credits and ensure the project sponsor objectives are met. What programs are available?
- Applications for Historic approval to VDHR, and LIHTC application to VH are submitted.
- Design and construction documents are assembled which reflects compliance with the Secretary of Interior's Standards for Historic Rehabilitation, and State/Local requirements to qualify for LIHTCs

2. Identify Financing Partners

- Gather information to solicit interest from third party investors, lenders, etc. and prepare marketing materials to solicit interest
- Tax Credit Transactions often require sophisticated financial modeling. Ensure you have a team that can help develop these models

3. Secure a Tax Credit Investor and Lender

- Negotiate term sheet with tax credit investors and lenders
- Analyze key components of proposals including pricing, timing of payment, transaction costs, other return requirements

4. Tax Credit Closing

- Once an agreement is reached, the closing process begins. More extensive due diligence is collected by the investor and closing documents are prepared by legal counsel.
- Docs are negotiated and at closing, investor is admitted into the project partnership and makes an initial capital contribution.

5. Post Closing Compliance/Exit

- Project receives final approval of tax credits. Typically investor makes its final capital contribution.
- Project becomes operational. Investor will expect some ongoing updates, tax returns, cash distributions during their time in the partnership.

ADDITIONAL PROGRAMS

- Federal Renewable Energy Investment Tax Credits
  - 22% tax credit for systems installed in 2021
  - Most of the same monetization rules as the FHTC program
- LIHTC developers often seek additional funding through numerous sources. Financing programs with good synergy include the HOME Investment Partnership Program, the Federal Home Loan Bank Affordable Housing Program, the USDA 538 Loan program, and the Community Development Block Grant Program.

- Federal New Markets Tax Credits – A competitive annual program intended to spur economic development in low-income communities
  - Accessing New Markets Tax Credits is facilitated through Community Development Entities (CDEs) who are awarded an allocation of NMTCs to invest in projects that fit their mission as a CDE.
  - The program provides an investment tax credit of 39% of the allocation provided to a project in a low-income community.
  - NMTC eligibility of a given project is based on the demographics of the census tract in which it is located.
  - Projects can often realize a net benefit of 16-23% of total project costs if a NMTC allocation is secured.

CONTACT INFORMATION

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