

Low-Income Housing Tax Credits: Affordable Housing Investment Opportunities for Banks

Abstract

The Low-Income Housing Tax Credit (LIHTC) is the federal government's primary program for encouraging the investment of private equity in the development of affordable rental housing for low-income households. Since its creation in 1986, the LIHTC has helped to finance more than 2.4 million affordable rental-housing units for low-income households.¹ This Insights report describes how LIHTCs are used to finance the development of affordable housing and how national banks and federal savings associations (collectively, banks) can participate as investors and lenders in LIHTC-financed projects. The report outlines the risks and regulatory considerations of LIHTC investments, including the considerations these investments receive in Community Reinvestment Act (CRA) examinations.

The Office of the Comptroller of the Currency (OCC) obtained the information for this report from a variety of sources, including banks, nonsupervised financial intermediaries, investment fund advisers, and other parties actively using LIHTCs to finance affordable housing. The information and examples offered are typical of LIHTC-financed projects. The report includes an overview of U.S. federal income tax laws and regulations applicable to the LIHTC program; however, the information in this report does not constitute tax advice, and investors should consult tax advisers about tax treatments for LIHTC investments.

Case studies of LIHTC-related financing are discussed in appendix A, B, C, and D. Appendix E lists abbreviations used in this report. Appendix F provides LIHTC resources.

I. What Is the LIHTC?

The LIHTC program was established as part of the Tax Reform Act of 1986 and is commonly referred to as section 42, the applicable section of the Internal Revenue Code (IRC). The LIHTC program provides tax incentives to encourage individual

¹ *What Happens to Low-Income Housing Tax Credit Properties at Year 15 and Beyond?*, U.S. Department of Housing and Urban Development (HUD), August 2012. The authors note that 2.2 million LIHTC-financed properties were placed in service from 1987 through 2009, the last year for which they had data. The authors estimate the total in 2011 was 2.4 million.

and corporate investors to invest in the development, acquisition, and rehabilitation of affordable rental housing.² The LIHTC is an indirect federal subsidy that finances low-income housing. This allows investors to claim tax credits on their federal income tax returns. The tax credit is calculated as a percentage of costs incurred in developing the affordable housing property, and is claimed annually over a 10-year period. Some investors³ may garner additional tax benefits⁴ by making LIHTC investments.⁵

The equity raised with LIHTCs can be used for newly constructed and substantially rehabilitated and affordable rental-housing properties for low-income households, and for the acquisition of such properties in acquisition/rehabilitation deals. LIHTCs provide equity equal to the present value of either 30 percent (referred to in this report as the 4 percent credit) or 70 percent (referred to as the 9 percent credit) of the eligible costs of a low-income housing project, depending in part on whether tax-exempt bonds are used to finance the project.

To qualify for the credit, a project must meet the requirements of a qualified low-income project. Project sponsors/developers (project sponsors) are required to set aside at least 40 percent of the units for renters earning no more than 60 percent of the area's median income (the 40/60 test) *or* 20 percent of the units for renters earning 50 percent or less of the area's median income (the 20/50 test).⁶ These units are subject to rent restrictions such that the maximum permissible gross rent, including an allowance for utilities, must be less than 30 percent of *imputed* income based on an area's median income.⁷

State selection procedures for tax credit allocations often encourage project sponsors to provide more than the minimum number of affordable units and greater than the minimum level of affordability. Because these credits are available only for affordable rental units, many applications designate 100 percent of units in properties as affordable and reserve some units for renters earning well below 50 percent of the area median income.⁸

² Tax Reform Act of 1986, Public Law 99-514, 100 Stat 2085, HR 3838, 99th Congress, 2nd Session, October 22, 1986. For the LIHTC provisions, see UL26 IRC 42. Because LIHTCs are commonly known as housing tax credits or tax credits, these terms are used interchangeably in this report. The LIHTC program became permanent under the Omnibus Budget Reconciliation Act of 1993.

³ *Low-Income Housing Tax Credit Handbook*, Novogradac & Co., sections 2.1 and 2.17, 2011. The number of taxpayers who can benefit from LIHTCs is limited by passive activity and alternative minimum tax rules. Widely held corporations are not subject to the passive loss rules and, as such, are, according to the author, ideal investors in low-income housing tax credit projects.

⁴ The return on the LIHTC investment can include (1) the stream of LIHTCs, (2) periodic distributions of funds from operations, (3) distribution upon sale of the project, and (4) periodic allocations of gains and losses from the project, including depreciation deductions, operating gains or losses, and gains or losses attributed to a capital event. See Hykan, Wayne H., "Pricing the Equity of a Tax Credit Project," *Journal of Affordable Housing and Community Development Law*, vol. 5, no. 4, 1996.

⁵ For buildings placed in service after 2007, LIHTCs may be used to offset both ordinary taxes and the alternative minimum tax. See 26 IRC 38(c)(4).

⁶ In New York City, a special 25/60 test is used in lieu of the 40/60 test. See 26 IRC 42(g)(4) and 142(d)(6).

⁷ The calculation of rents for tax credit units is complicated because the imputed number of people per bedroom (i.e., 1.5 people) and the number of bedrooms in a unit are included. For more information on income limits, see www.huduser.org/portal/datasets/il.html. For LIHTC calculators, see www.novoco.com/products/rentincome.php and www.danter.com/TAXCREDIT/getrents.HTML.

⁸ For information on HUD's LIHTC eligibility, see www.hud.gov/offices/cpd/affordablehousing/training/web/lihtc/basics/eligibility.cfm.

The LIHTC program works as follows. The Internal Revenue Service (IRS) allocates federal tax credits to state housing credit agencies (HCA) based on each state's population. In the case of 9 percent credits, project sponsors (who hold general partner interests in the final ownership entities of developments) of proposed low-income housing projects apply through a competitive process for allocations of tax credits from state HCAs. The state agencies award LIHTCs for qualified affordable housing projects based on point systems reflecting each state's priorities for the desired type, location, and ownership of affordable housing. Project sponsors use the tax credits to raise equity from private investors. The equity investment reduces the debt burden on the tax credit property, making it financially feasible to offer lower, more affordable rents. Often institutional investors such as banks use the tax credits and real estate losses to lower their federal tax liabilities.

Once a property is placed into service, the tax credits are claimed annually over a 10-year period; however, the project must satisfy specific low-income housing compliance rules for the full 15-year compliance period. If the project fails to comply with LIHTC program rules during the 15-year compliance period, the IRS may recapture previously claimed credits. The property must remain affordable for at least 30 years; however, after the initial 15-year compliance period ends, the IRS may not recapture the tax credits.⁹ Investors may exit the partnership at any time and not face recapture of tax credits as long as the property continues to operate as affordable housing through the end of year 15. Most often, investors exit between year 11 and 16, having collected tax credits for 10 years or more.

Project sponsors structure LIHTC projects as limited partnerships or limited liability companies¹⁰ to limit financial risk exposure for investors. This structure allows tax credit benefits and real estate losses to pass through to investors.¹¹ The investment in an LIHTC-financed project occurs in one of two ways: by a direct investment in a single project through a partnership, as shown in figure 1, or by an investment in a syndicated LIHTC-equity fund, as shown in figure 2.

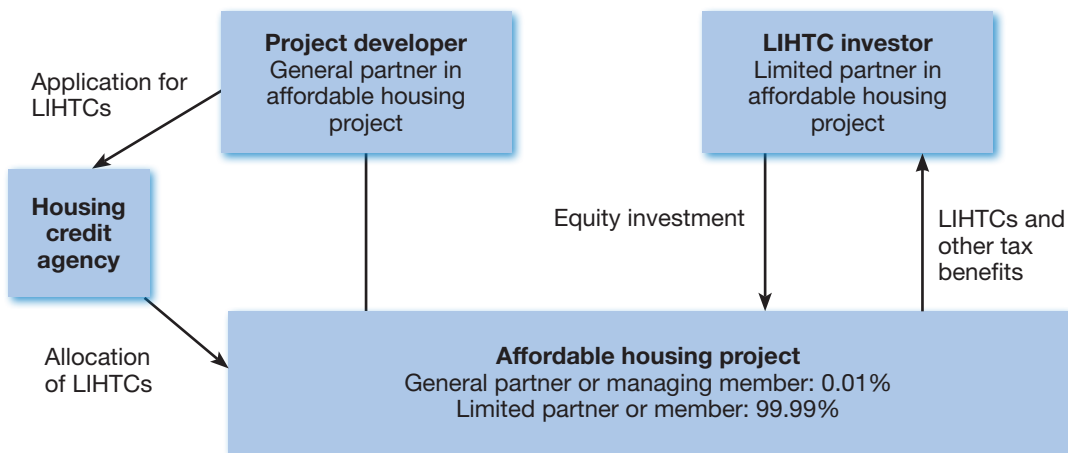
Figure 1 illustrates the typical legal structure for a direct investment in an LIHTC-financed project. The project sponsor/developer applies to a state HCA for an LIHTC allocation for a specific affordable housing project. If approved, the tax credits are allocated to the affordable housing project. The tax credits provide an incentive for equity investors. The project sponsor offers investors an ownership interest in the affordable housing project. When making a direct investment, an investor acquires all or a portion of the 99.99 percent ownership in the partnership. While having an ownership interest, the investor has no management authority. The direct investor receives tax credits and real estate losses through the partnership in proportion to the investor's ownership interest in the project.

⁹ For more information on noncompliance and the possible recapture of tax credits, see 26 IRC 42(j). There are no consequences for an original investor after the 15-year compliance period; however, the owner of the property is subject to legal action by the HCA in the event of noncompliance issues.

¹⁰ The term "partnership" refers to limited partnerships (LP) and limited liability companies (LLC).

¹¹ Under federal income tax law, LIHTCs may be claimed only by property owners who have the benefits and burdens of ownership. This includes all partnerships (LPs, LLCs, and other equity investors) in the properties. For example, if a bank holds a 99.99 percent interest in a partnership, it receives 99.99 percent of the tax credits and real estate losses, which include, but are not limited to, depreciation and interest expenses.

Figure 1: Typical Legal Structure for Direct Investment in LIHTC-Financed Project

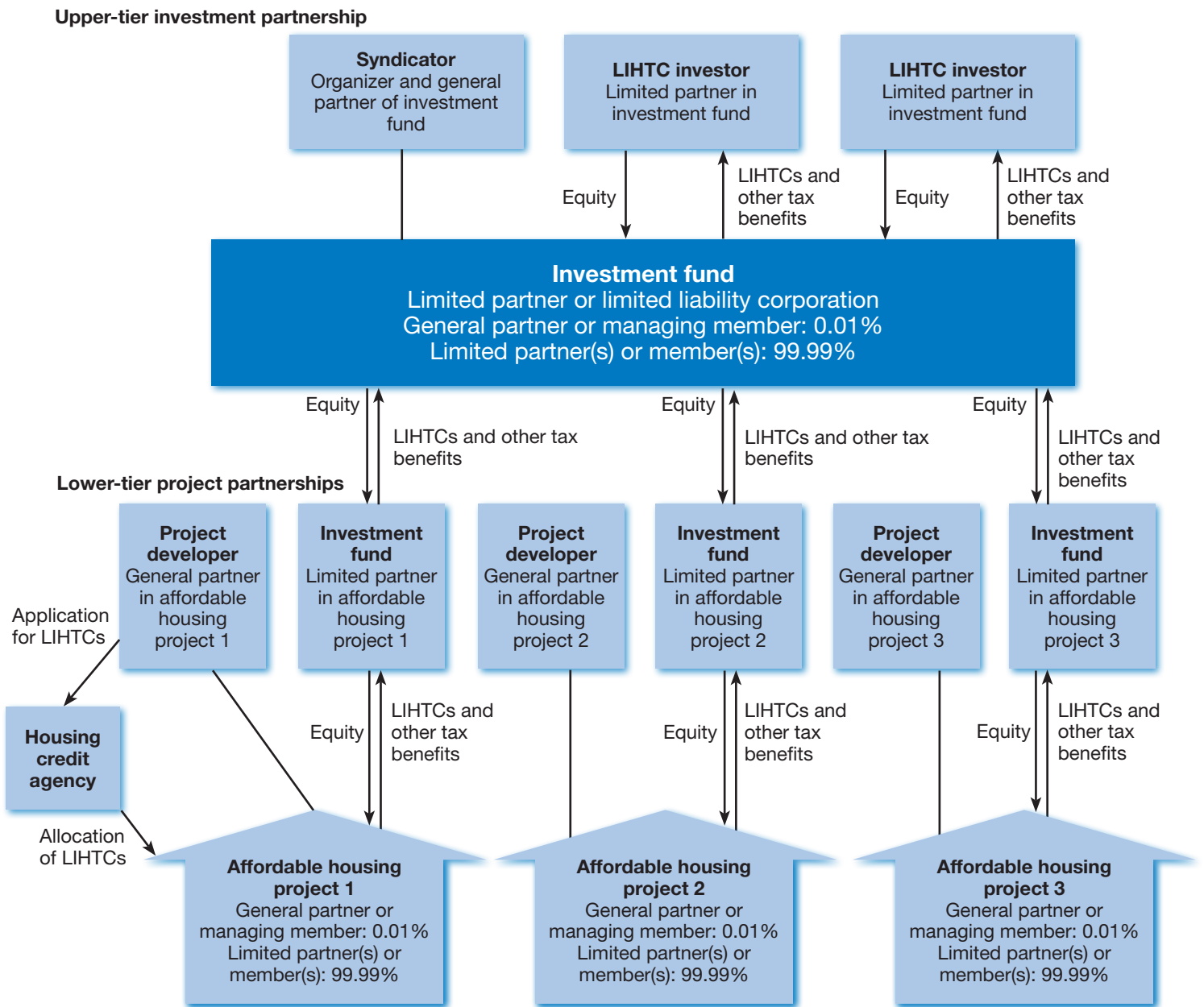


Source: OCC

Figure 2 illustrates the typical legal structure for an investment in a syndicated LIHTC-equity fund. The syndicator organizes one or more investors and forms an investment fund, and the fund invests in one or more affordable housing projects. Thus, a two-tier partnership structure is created with funds from investors combining in the upper-tier investment partnership and funds from pooled equity financing multiple, lower-tier property partnerships. Investors hold 99.99 percent ownership of the investment fund; the syndicator, as general partner or managing member, holds 0.01 percent ownership.

Figure 2 illustrates the investment fund's investment in three lower-tier property partnerships (projects AHP 1, AHP 2, and AHP 3). Each property partnership receives an LIHTC allocation from a state HCA and then uses those credits to attract investors. As a result of its investment, the fund holds 99.99 percent ownership in each project; the developer/general partner of each property holds 0.01 percent ownership. The tax credits flow from the lower-tier partnerships to the upper-tier partnership, where investors share the credits based on their ownership proportion in the fund.

Figure 2: Typical Legal Structure for Investment in a Syndicated LIHTC-Equity Fund



Source: OCC

Equity funds offer LIHTC investors lower barriers of entry because syndicators often set minimum investment amounts lower than the minimums required for direct investments. In multi-investor funds, minimum investments start at about \$1 million, while regional funds focused on community banks and smaller corporations may have lower investment minimums. Across the nation, national, state, and regional LIHTC funds are available to investors.¹² Equity funds offer investors different risk/reward profiles in terms of pooled investments, portfolio diversity, the syndicator’s expertise in finding and financing quality projects, and lower administrative overhead. Section IV discusses the risks of LIHTC investments.

II. Why Are LIHTCs of Interest to Banks?

Banks choose to invest in and lend to LIHTC-financed projects because this helps them in

- meeting the credit needs of their communities.
- receiving CRA consideration.
- earning competitive rates of return on investments.
- gaining opportunities to diversify into other credit products and services.
- providing a platform to leverage other tax credit investments.

Meeting Community Credit Needs

The National Association of Home Builders published a report that found that more than 19.4 million households, or 49 percent of total households renting homes in 2010, were “rent-burdened,” or paying more than 30 percent of household income for rent.¹³ They found the LIHTC to be an important program for financing housing that addresses this community need.

According to two other industry-sponsored reports, the private capital and market discipline provided by LIHTC investors, lenders, and developers have made LIHTC-financed housing among the most successful affordable rental housing production programs offered by the federal government.¹⁴ Decisions to develop and finance affordable housing using LIHTCs are based on local needs for housing and community development. The projects are often initiated by a community-based sponsor. All projects must have sufficient local demand to meet cash flow projections. Tax credit allocations must be consistent with state housing priorities.

Banks can participate in affordable housing developments as investors using LIHTCs, providing equity in exchange for the tax credits—or as lenders, providing short- or long-term financing. Because they are experienced in housing development and commercial real estate finance and are responsible for meeting the credit needs of their communities, banks are the primary investors in LIHTCs for affordable housing development.

¹² One such example is the National Equity Fund, a syndicator of LIHTC and other tax credits. For more information, see www.nefinc.org. Across the nation, there are at least 30 local and state equity funds LIHTC-qualified to provide equity capital for rental housing developments. For information on these funds, visit the National Association of State and Local Equity Funds at www.naslef.org.

¹³ Data are from the American Community Survey, *Census Data Reveal Geography of Rent Burdened Families*, National Association of Home Builders, October 25, 2011. See <http://eyeonhousing.wordpress.com/2011/10/25/census-data-reveal-geography-of-rent-burdened-families>.

¹⁴ *The Low Income Housing Tax Credit: The Most Successful Affordable Rental Housing Production Program in Our Nation’s History*, National Association of Home Builders, October 26, 2011, www.nahb.org/fileUpload_details.aspx?contentID=151606. See also *Low-Income Housing Tax Credit: Assessment of Program Performance & Comparison to Other Federal Affordable Rental Housing Subsidies*, Novogradac, May 2011, www.novoco.com/products/special_report_lihtc.php.

Receiving CRA Consideration

An important incentive for banks investing in LIHTCs is the CRA consideration they may receive for making these investments. A bank may receive CRA consideration for community development activities related to LIHTC projects and funds, provided the activities benefit a bank's assessment area or a broader statewide or regional area that includes the bank's assessment area(s) (AA). The bank's AA(s) need not receive an immediate or direct benefit from the bank's participation in the activity, provided the purpose, mandate, or function of the activity includes serving geographies or individuals located within the institution's AA(s). Examiners consider these activities even if they do not benefit the bank's AA(s), as long as the bank has been responsive to community development needs and opportunities in its AA(s).¹⁵

Examples of activities that may be eligible for CRA consideration include direct investments in LIHTC projects, predevelopment financing or construction/permanent financing to LIHTC projects, investments in funds that specialize in funding and managing LIHTC projects, and technical assistance to nonprofit organizations that help identify and counsel potential low- or moderate-income residents. Investments in state and municipal obligations, such as revenue bonds that specifically support affordable housing (including 4 percent LIHTC projects), also meet the CRA definition of qualified investments.

In addition, a bank may receive CRA consideration for activities that revitalize or stabilize designated disaster areas and designated distressed or underserved nonmetropolitan middle-income geographies. Activities in these specially designated areas must benefit the bank's AA(s), or a broader statewide or regional area that includes the bank's AA(s), in order to receive CRA consideration. In limited and specific instances, as determined by the federal financial regulatory agencies, a bank can make qualified investments in disaster areas that are outside these areas, provided the bank has adequately been responsive to needs in its AA(s).¹⁶

Earning Financial Returns

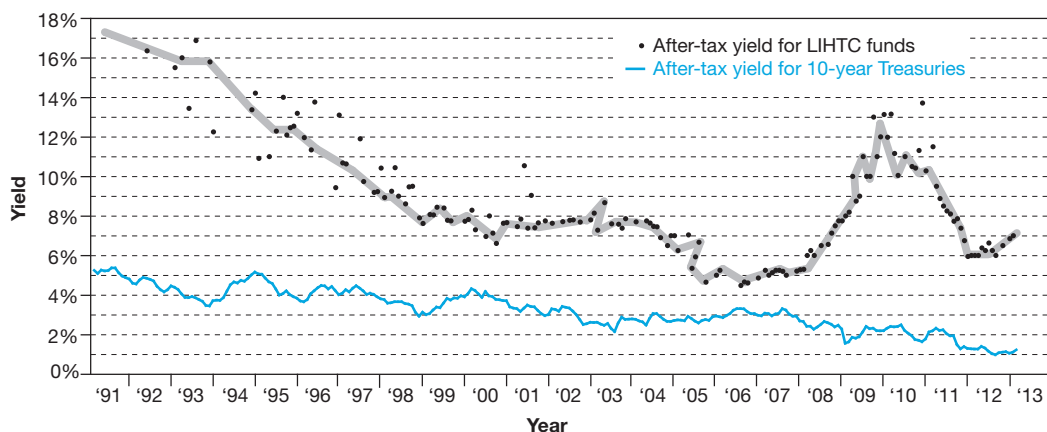
A bank's return on an LIHTC investment depends on a number of factors, including the bank's underwriting and management of the investment. As an asset class, historic returns on investments and loans in LIHTC projects have been competitive with similar alternative investment opportunities. Figure 3 illustrates the after-tax yield on LIHTC investments as compared with the after-tax 10-year U.S. Treasury yields from 1991 through 2013.¹⁷

¹⁵ "Community Reinvestment Act; Interagency Questions and Answers Regarding Community Reinvestment; Notice," Fed. Reg., no. 2013-27738, pages 69671–69680, November 20, 2013. There may be several ways to demonstrate that the financial institution's investment in a nationwide investment fund meets the geographic requirements, and the agencies will employ appropriate flexibility in this regard in reviewing information the institution provides that reasonably supports this determination. In making this determination, the agencies will consider any information provided by a financial institution that reasonably demonstrates that the purpose, mandate, or function of the fund includes serving geographies or individuals located within the institution's assessment area(s) or a broader statewide or regional area that includes the institution's assessment area(s). Typically, information about where a fund's investments are expected to be made or targeted will be found in the fund's prospectus, or other documents provided by the fund prior to or at the time of the institution's investment, and the institution, at its option, may provide such documentation with its CRA evaluation.

¹⁶ See "Interagency Questions and Answers Regarding Community Reinvestment," 75 Fed. Reg. 11642, __.12(g)(4)(ii)-1, March 11, 2010. See also OCC Bulletin 2012-8, "Community Reinvestment Act Consideration for Gulf Coast Disaster Area Activities: Extension of Deadline," February 27, 2012; and the OCC's *Community Developments Fact Sheet: Designated Disaster Areas and Consideration Under the Community Reinvestment Act*, October 2012, www.occ.gov/topics/community-affairs/publications/fact-sheets/fact-sheet-designated-disaster-areas-cra.pdf.

¹⁷ From Treasury Department and industry survey data compiled by Richard Floreani, Carlisle Tax Credit Partners, June 2011.

Figure 3: After-Tax Yield Trends for LIHTCs and 10-Year Treasuries, 1991-2013

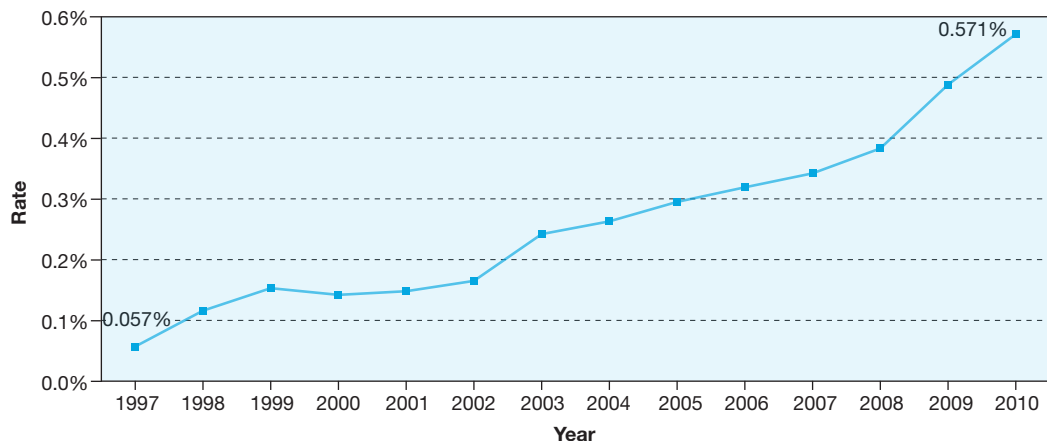


Source: Carlisle Tax Credit Advisors, 2013

Note: Tax credits are shown by month where one or more multi-investor funds were available. Treasury bond data are plotted monthly.

Foreclosures of LIHTC projects have been relatively rare, according to a CohnReznick study of participating syndicators who reported a 0.57 percent cumulative foreclosure rate of LIHTC properties placed into service from 1997 through 2010.¹⁸ This compares favorably to the foreclosure rate of market-rate multifamily properties and other real estate asset groups.¹⁹

Figure 4: Cumulative Foreclosure Rate Less Than One Percent for LIHTC-Financed Properties, 1997-2010



Source: CohnReznick

¹⁸ See *The Low-Income Tax Credit Program at Year 25: An Expanded Look at its Performance*, CohnReznick, December 2012, www.cohnreznick.com/insights/low-income-housing-study. The report suggests the number of foreclosures has been underreported as a result of incomplete data, for example, nonresponders to survey, missing data from inactive firms, cases of cured defaults, debt restructure strategies, or where additional capital calls may have been undertaken in lieu of foreclosure.

¹⁹ See the *Low Income Housing Tax Credit Program at Year 25: A Current Look at Its Performance*, CohnReznick, August 2011, www.cohnreznick.com/sites/default/files/reznickgroup_lihtc_survey_2011.pdf. The authors note that “while the number and rate of foreclosures increased incrementally from 2008 through 2010, the incidence of foreclosures in housing tax credit properties continues to compare very favorably with the foreclosure rate of market-rate multifamily properties and other real estate asset groups.”

Gaining Additional Commercial Lending Opportunities

Participating in LIHTC projects provides banks with opportunities to expand existing customer relationships and to develop new customer relationships. LIHTC-financed projects often require additional loan products and bank services, including

- pre-development and acquisition loans.
- bridge loans.²⁰
- construction loans.
- permanent mortgage financing.
- letters of credit.²¹
- warehouse lines of credit.²²

Leveraging Other Tax Credit Investments

Depending on the age and location of the properties, LIHTCs may be combined with historic tax credits (HTC)²³ or renewable energy tax credits (RETC).²⁴ Projects using multiple types of credit, referred to as “twinned” transactions, are popular with some project sponsors/developers and bank investors. Additionally, some states have established housing tax credit programs, and these state credits may be twinned with LIHTCs. Blending federal LIHTCs with HTCs, RETCs, or state housing tax credits can improve the internal rates of return on these transactions for investors.

III. How Does the LIHTC Program Work?

Financing the Project

Affordable housing properties are financed with two kinds of LIHTCs: the 9 percent credit and the 4 percent credit. Projects using conventional debt without federal subsidies²⁵ are eligible for the 9 percent credit. An allocation of 9 percent credits yields tax credits over a 10-year period with a present value of 70 percent of eligible costs to construct the low-income units (qualified basis).²⁶ The 4 percent credit is used in projects financed with tax-exempt bonds. An allocation of 4 percent credits yields tax credits over a 10-year period with a present value of 30 percent of eligible costs to construct the low-

²⁰ Bridge loans are short-term credit facilities provided by banks to tax credit investors to cover their capital calls during construction periods. Also known as subscription obligation financing, these credit facilities are typically secured by the unconditional commitment of investors. These credit facilities are used by syndicators to generate higher internal rates of return required to attract investors as well as to better manage the capital call process.

²¹ Banks can enhance the credit ratings of state HCA-issued tax-exempt bonds by providing letters of credit. on bonds. Tax-exempt bonds are often used to finance 4 percent LIHTC transactions.

²² Banks provide warehouse lines of credit to syndicators to finance the acquisition of LIHTC properties. The repayment source is equity from fund investors.

²³ The Federal Historic Preservation Tax Incentives program is jointly administered by the IRS and the National Park Service. For more information, see www.nps.gov/tps/.

²⁴ *Investing in Solar Energy Using the Public Welfare Investment Authority*, OCC Community Developments Investments, July 2011, www.occ.gov/static/community-affairs/community-developments-investments/solar11/2011-solar-cdezine-final.pdf. See also “Rural Housing Initiatives at Work,” OCC Community Developments, 2003, www.occ.gov/static/community-affairs/2003spring03.pdf.

²⁵ As defined in 26 IRC 42(i)(2).

²⁶ The amount of credits that a project owner may claim with respect to a building is based on the percentage of the building that is occupied by low-income tenants. The qualified basis is generally equal to the product of the low-income occupancy percentage and the eligible basis (e.g., construction costs less land cost, disproportionate standard costs, commercial property, permanent loan costs, syndication costs, and the cost of tenant facilities if additional charges for use).

income units (qualified basis).²⁷ In addition, properties located in federally designated areas of high development costs or poverty levels may be eligible for a larger allocation, or “boost,” of LIHTCs than would normally be available.

9 Percent Tax Credit

A newly constructed building or the substantial rehabilitation of an existing building is eligible for the 9 percent credit, unless the building is financed with tax-exempt bonds. If other federal subsidies are used in the financing, the partnership may elect to exclude the federal subsidies from the eligible basis and still claim the 9 percent credits. The definition of “federally subsidized” has made it easier for buildings placed in service after July 30, 2008, to receive 9 percent credits.²⁸

The pool of 9 percent credits in any given year is limited. For each state, the annual volume cap for 9 percent tax credits is measured as the product of a fixed per capita rate multiplied by the state’s population. The credits are allocated by state HCAs through a competitive process.

Federal law requires each state HCA to have a qualified allocation plan (QAP), which sets out the state’s priorities and eligibility criteria for awarding 9 percent tax credits as well as state tax-exempt private activity bonds.²⁹ The QAP gives preference to projects that

- serve the lowest-income residents.
- serve income-eligible residents for the longest time frame.
- are located in qualified census tracts, tracts with a poverty rate of 25 percent, or tracts in which 50 percent of the households have incomes below 60 percent of the area median income and contribute to a community’s revitalization plan.

A state’s QAP may give bonus points to projects with specific goals and set aside a percentage of credits (targeted tax credit allocations) for projects that serve specific populations or locations.³⁰

HCAs consider project readiness a primary consideration in evaluating tax credit applications. If an LIHTC project receiving an allocation of 9 percent credits is not placed in service by the end of the calendar year in which it received its allocation, the project must meet a minimum level of completion referred to as the 10 percent test. The 10 percent test requires the owner to demonstrate that it has incurred at least 10 percent of

²⁷ For existing properties acquired and rehabilitated without tax-exempt bonds, the 4 percent credit applies to the acquisition cost of the property and the 9 percent credit applies to the rehabilitation of the property.

²⁸ A federal subsidy is any debt obligation the interest of which is exempt from tax under 26 IRC 103, or a direct or indirect federal loan, if the interest rate on such loan is below the applicable federal rate (AFR) in effect as of the date the loan was made. Pursuant to the Housing and Economic Recovery Act of 2008 (HERA), “any below market federal loan(s)” were removed as one of the ways a building could become classified as federally subsidized. This effectively changes the definition of federally subsidized to only mean tax-exempt bonds. These new laws are effective for buildings that are placed in service after July 30, 2008. See *Low-Income Housing Tax Credit Handbook*, Novogradac, 2011.

²⁹ See 26 IRC 42(m), which sets forth the QAP requirements for HCAs. For a detailed discussion of QAPs by the National Low Income Housing Coalition, see <http://nlihc.org/issues/other/lihtc>.

³⁰ The HCA’s selection criteria must address the following: location, housing needs, public housing waiting lists, individuals with children, special needs populations, whether a project includes the use of existing housing as part of the community revitalization plan, project sponsor characteristics, and projects intended for eventual tenant ownership. Because these criteria are minimums, states can adopt more rigorous criteria aimed at meeting specific housing needs in the state. See 26 IRC 42(m)(1)(C).

the project's reasonably expected basis³¹ within 12 months of the date of allocation. Once the project has met the 10 percent test, the project must be placed in service by the end of the second calendar year following the year of allocation.³² Failure to adequately satisfy the 10 percent test can cause a project to lose its tax credit allocation and the ability to market the tax credits for sale to investors.³³

4 Percent Tax Credit

If 50 percent or more of the project's eligible costs are financed with tax-exempt private activity bonds,³⁴ the project sponsor/developer may claim a 4 percent LIHTC without having to obtain a credit allocation from the HCA.³⁵ Although the process to obtain bonds is competitive and requires the project sponsor/developer to submit an application, once the HCA decides to issue the bonds, the project sponsor/developer is not required to compete separately for a tax credit allocation.

The 4 percent credits are roughly equal to 30 percent of the qualified basis of a newly constructed building or the cost of the acquisition and substantial rehabilitation of an existing building.³⁶ Because the 4 percent credit is much shallower than the 9 percent credit, project sponsors/developers of 4 percent tax credit projects often seek additional funding through numerous sources, including but not limited to such federal programs as the HOME Investment Partnership Program (HOME),³⁷ the Federal Home Loan Bank Affordable Housing Program, and the Community Development Block Grant Program. Other sources may include state agency loans and private foundation grants. Appendix B illustrates an example of a 4 percent LIHTC project.

³¹ Terence Kimm, *10 Percent Test Not Graded On A Curve*, Affordable Housing Finance, April 1, 2008, www.housingfinance.com/accounting/10-percent-test-not-graded-on-curve.aspx. The 10 percent test is a fraction calculated as follows. The numerator is the taxpayer's adjusted basis in land and depreciable property that is reasonably expected to be part of the project as of the measurement date determined by the HCA. The denominator is the taxpayer's adjusted basis in land and depreciable property that is reasonably expected to be part of the project as of the close of the second year following the year of allocation. Note that the description of neither the numerator nor the denominator mentions eligible basis. Therefore, costs related to any commercial component of the project are includable in both. Additionally, any basis boost as a result of the project being located in a qualified census tract or difficult development area is ignored. Stated more simply, the numerator is the taxpayer's basis in land and depreciable property incurred as of the measurement date, and the denominator is the taxpayer's expected basis in land and depreciable property at completion of construction.

³² See 26 IRC 42(h)(1)(E), as amended by H.R. 3221, HERA, 3004(b).

³³ *Low-Income Housing Tax Credit Handbook*, Novogradac, section 3:172, 2011.

³⁴ For buildings placed in service on or before July 30, 2008, a new or substantially rehabilitated building that receives a federal subsidy is not eligible for the 9 percent credit. Instead, it is eligible for the 4 percent credit. HERA removed the phrase "any below-market federal loan" as one of the ways a building can become classified as federally subsidized. For buildings placed in service after July 30, 2008, the definition of federally subsidized means only those projects financed with tax-exempt bonds.

³⁵ The actual tax rate is not exactly 4 percent. This rate, commonly referred to as the applicable federal rate (AFR), is indexed to 10-year U.S. Treasury bond yields. Monthly AFRs are available in table 4 at www.irs.gov/app/picklist/list/federalRates.html.

³⁶ State HCAs may delegate authority to local HCAs to issue state tax-exempt private activity bonds or local HCAs may issue local tax-exempt private activity bonds for financing eligible projects following the state HCA's underwriting criteria. The project sponsor/developer receiving the tax-exempt bond allocation would apply to the state HCA to receive 4 percent tax credits.

³⁷ The HOME program, authorized under Title II of the Cranston-Gonzalez National Affordable Housing Act, regulated under 24 CFR 92, provides federal block grants to state and local governments to create affordable housing for low-income households.

The benefit of combining tax-exempt bond financing with 4 percent LIHTCs is that these tax credits are not in competition with projects seeking the 9 percent tax credit allocations.

Difficult Development Areas and Qualified Census Tracts

If a project is located in a difficult development area (DDA) or a qualified census tract (QCT), the eligible basis³⁸ of the project can be increased by 30 percent. This allowable increase is commonly referred to as a basis boost.³⁹ DDAs are locations that have high construction, land, and utility costs relative to the area median gross income. QCTs are tracts with a poverty rate of at least 25 percent, or tracts where 50 percent of the households have incomes below 60 percent of the area median income.⁴⁰ For properties placed into service after July 30, 2008, HCAs have the authority to select specific buildings not already in DDAs or QCTs to receive the 30 percent basis boost.⁴¹ This building-specific designation is not available for projects financed with tax-exempt bonds. Appendix A illustrates how a 30 percent basis boost is applied.

Claiming the Credit and Project Compliance

LIHTC investors can begin claiming tax credits only after the buildings are placed in service and are occupied by qualified tenants and proper filings have been made with the state HCA and the IRS.⁴² The rental units must be leased to income-eligible households, and the rents must be within allowable limits. Although tax credits are claimed annually over 10 years, the investment compliance period continues until the end of the 15th year, and the project must remain affordable for at least 30 years. Corporate and eligible individual investors can benefit from the partnership's pass-through of real estate losses, such as depreciation and interest expense, associated with income-producing real estate.

Table 1 illustrates the combined benefits of a sample 9 percent transaction. If the qualified basis for an LIHTC project is \$10 million, then 9 percent credits produce an annual tax credit of \$900,000, totaling \$9 million for the investor over 10 years.⁴³ The table shows an additional estimated \$2,205,294 generated through various real estate losses—such as depreciation and interest expense—that are passed through to investors. The combined tax benefit is \$11,205,294 over the life of the investment.

³⁸ The eligible basis refers to the construction costs that can be included in the LIHTC calculations. The eligible basis includes most hard costs, such as construction costs, and most depreciable soft costs. Excluded are land, commercial space, and any portion of professional fees (such as consulting or developer fees) that are above state-determined limits. For an expanded discussion on eligible basis, see *Low-Income Housing Tax Credit Handbook*, Novogradac, section 3:59, 2011.

³⁹ A basis boost increases the eligible basis (eligible project development costs) used to calculate the annual tax credit by up to 30 percent. 26 IRC 42(d)(5).

⁴⁰ In 2004, HUD designated DDAs and QCTs for purposes of the LIHTC program under 26 IRC 42. See “Statutorily Mandated Designation of Difficult Development Areas” for section 42, IRC, 1986, 69 Fed. Reg. 69,731, November 30, 2004. For current listings, see www.huduser.org/portal/datasets/qct.html.

⁴¹ See 26 IRC 42(d)(5)(B) as amended by H.R. 3221, HERA, 3003(g)(s).

⁴² The taxpayer may elect to have the credit period begin in the succeeding taxable year. For more information, see 26 IRC 42(f)(1) and 42(h)(1)(B).

⁴³ The annual 9 percent housing tax credit calculation is based on the flat 9 percent rate.

Table 1: Hypothetical LIHTC Project Benefit Schedule, 9 Percent Tax Credits

	Tax credits using an AFR ^a =9%	Total real estate losses (Depreciation, interest expense, etc.)	Income derived from real estate tax losses ^b	Combined benefit
	(\$)	(\$)	(\$)	(\$)
Qualified basis ^c	10,000,000			
Annual housing tax credits (Qualified basis multiplied by applicable AFR)	900,000			
Year 1	900,000	(568,948)	199,132	1,099,132
Year 2	900,000	(685,198)	239,819	1,139,819
Year 3	900,000	(595,005)	208,252	1,108,252
Year 4	900,000	(531,175)	185,911	1,085,911
Year 5	900,000	(506,163)	177,157	1,077,157
Year 6	900,000	(452,570)	158,400	1,058,400
Year 7	900,000	(403,646)	141,276	1,041,276
Year 8	900,000	(387,536)	135,638	1,035,638
Year 9	900,000	(370,583)	129,704	1,029,704
Year 10	900,000	(352,275)	123,296	1,023,296
Year 11	0	(333,146)	116,601	116,601
Year 12	0	(312,529)	109,385	109,385
Year 13	0	(290,949)	101,832	101,832
Year 14	0	(267,729)	93,705	93,705
Year 15	0	(243,387)	85,185	85,185
Year 16 (disposition)	0			
Total	\$9,000,000		\$2,205,294	\$11,205,294

Source: OCC

^a The applicable federal rate (AFR) represents the IRS method of calculating the present value of the credits to investors. In accordance with section 42 (b)(2), the IRS publishes monthly AFRs for the LIHTC program. The AFRs are indexed to 10-year U.S. Treasury bond yields. ERA established a floor of 9 percent on the credit for non-federally subsidized rehabilitation and new construction buildings placed in service after July 30, 2008, with respect to housing credit dollar amount allocations made before January 1, 2014.

^b The tax losses an investor may receive on a property are based on the amount of equity contributed to the project. In this example, \$7.2 million (\$0.80 per credit) was contributed as equity. Real estate losses in each year are calculated assuming an annual corporate tax rate of 35 percent. At disposition, any remaining tax capital is lowered by distributions of remaining cash or losses from sale, so that the amount of cash and losses equals the original investment. For the \$7.2 million equity investment, total net tax benefits from real estate losses are \$2,205,294. This example assumes no cash distributions.

The amount of real estate losses varies by year. In this table, the year 1 tax benefit of \$199,132 is equal to \$568,948 (year 1 losses) multiplied by the corporate tax rate or 35 percent. The project becomes operational, creating a somewhat higher tax deduction in year 2. Accelerated depreciation of the underlying assets (principally site improvements and personal property) results in a declining balance of tax deductions through year 15. The residual property value in this table is zero.

^c The qualified basis is defined as the product of the eligible basis multiplied by the proportion of the project's affordable housing units (applicable fraction). The eligible basis refers to the construction costs that can be included in the LIHTC calculations. The eligible basis includes most hard costs, such as construction costs, and most depreciable soft costs. Excluded are land, commercial space, and any portion of professional fees (such as consultant or developer fees) that are above state-determined limits.

If the partnership fails to comply with LIHTC-rental rules at any time during the 15-year compliance period, any previously claimed credits may be subject to recapture. If the compliance issue is not resolved within the “cure period,”⁴⁴ any future credits are also jeopardized.

During the compliance period, the LIHTC-financed units must be rented to income-eligible tenants, and rents must be within allowable limits. Projects with credits allocated after 1989 must be rent-restricted and occupied by income-eligible households for at least 30 years.⁴⁵ This 30-year restriction period, including the 15-year compliance period, is called the “extended use period.”

Exiting the Transaction

Investors often exit the partnership after the 15-year compliance period because they no longer receive tax credits, and noncompliance after the 15-year compliance period does not trigger credit recapture. State HCAs do, however, require the partnership to adhere to LIHTC rules, including rent restrictions and tenant income requirements, through the 15-year extended use period following the compliance period. Investors must also consider their tax liabilities when LIHTC properties or partnership interests are sold.

The terms of the investors’ exit are established in the partnership agreement. The general partner’s purchase of the limited partner investors’ interest is the most common form of investor exit. When negotiating with the general partner over the terms of the limited partner buyout, limited partners should factor into their establishment of the exit price the general partner’s need to maintain the requisite restricted rents during the extended-use period. Funds in project reserves may be needed to keep the project economically viable. Additional general partner debt taken on to buy out the limited partners may limit the project’s ability to maintain restricted rents during the extended-use period.⁴⁶

Some investors choose to exit the partnership before year 15. Their exit has been made easier by the regulatory removal of the recapture bonding requirement for properties placed in service after July 30, 2008. Investors should consider, however, that the threat of recapture still exists through year 15, even if they have exited the transactions before this time.⁴⁷

IV. What Are Key Risks and Regulatory Issues Associated With LIHTCs?

Banks active in the LIHTC business initially review these investments as commercial real estate transactions. Once a bank is satisfied with its normal due diligence of the transaction, it needs to be comfortable with this transaction as a long-term investment.

Overview

While investing in LIHTCs has benefits, there are risks that need to be identified and understood. Careful planning, selection of good partners, and diligent oversight can help banks mitigate risks.

⁴⁴ A provision in a contract allowing a defaulting party a specific period of time to fix the cause of the default.

⁴⁵ Some states require low-income housing commitments greater than 30 years or provide incentives for project sponsors/developers that voluntarily agree to longer commitments. *2012 Advocates’ Guide to Housing and Community Development Policy*, National Low-Income Housing Coalition, 2012, p. 122.

⁴⁶ HUD, *What Happens to Low-Income Housing Tax Credit Properties at Year 15 and Beyond?*, August 2012, pp. 10–12, 44, and 48. See also “Squeezing the Housing Credit at Both Ends,” Bipartisan Housing Center, <http://bipartisanpolicy.org/blog/housing/2014/03/11/squeezing-housing-credit-both-ends>. [URL added April 18, 2014.]

⁴⁷ *Winding Down LIHTC Fund Partnerships: Disposition Issues*, Reznick Group, (November 2011), http://staging.reznickgroup.com/sites/reznickgroup.com/files/papers/ah_fall2011_windingdown_lihtcfundpartnerships.pdf.

Banks have responsibilities as investors in these projects. LIHTC projects and syndicated funds often have minimum investment thresholds that can present barriers for some banks. Pledged funds must be available when needed. In some cases, additional unscheduled capital calls may be required to address problems with certain properties.

Investors need to be aware of the processes for project selection and ongoing operating oversight. The LIHTC program is intended to meet public goals. Bank investors can face reputational risk when those public goals are poorly or unsuccessfully met.

The potential loss of the tax credit and recapture by the IRS represent significant risks to bank investors. Tax credits are available to investors when projects provide affordable housing to qualifying low-income tenants. The projects must be built within specified periods, operated with financial and operational discipline, and according to regulatory requirements over the 15-year compliance period. Because the tax credits are available over extended periods, bank investors must be able to project taxable income and losses over the term of the investment.

Tax credits are recaptured if a project does not lease its minimum set-aside of low-income rental units to income-qualified tenants at affordable rents during the 15-year compliance period. The amount of the recapture is based on the prior LIHTCs claimed by the bank investor and the time elapsed since the tax credits were first claimed.⁴⁸ Once the 15-year compliance period is over, the IRS cannot recapture the tax credits and the bank investors often exit the LIHTC partnership.⁴⁹

Banks have several choices when making LIHTC investments, including multi-investor funds, specialized funds, private-label funds, and direct investments.⁵⁰ The choice of investment method depends on numerous factors, including the amount of the investment, the bank's internal capacity, and the costs of risk mitigation. LIHTC investment funds involve syndicators that specialize in managing the process of acquiring and overseeing LIHTC projects. Syndicators can offer specialized expertise in understanding affordable housing markets, working with nonprofit and for-profit developers and addressing any problems that arise. Multi-investor and specialized funds can spread risk across multiple investors and projects.

Assessing a Bank Investor's Needs and Capacities

Banks considering investing in LIHTCs must assess their internal needs and capacities. This assessment starts with a careful review of projected tax needs. To realize the financial benefit of the tax credits, the bank investor needs to have a sufficient federal tax liability for at least 10 to 12 years. LIHTC program regulations allow some flexibility if an investor's tax needs are not uniform. LIHTCs can be carried forward or back, with limitations,⁵¹ although this can affect the investor's rate of return. While there is no organized secondary market for LIHTC investments, an investor may transfer a

⁴⁸ See 26 IRC 42(j)(1-3), which provides detailed information about the calculation of recaptured tax credits plus interest for the 15-year period of compliance. See 26 IRC 42(j)(6)(A) for a description of conditions pursuant to which liability may be discharged through the posting of a bond.

⁴⁹ While there are not consequences for the original investor after the 15-year compliance period, the owner of the property is subject to legal action by the HCA in the event of noncompliance.

⁵⁰ Smith, David A., *Vehicles, Drivers, and Road Maps*, National Affordable Housing Management Association News, January/February 2011, www.recapadvisors.com/wp-content/uploads/2013/11/NAHMA_News_Smith_vehicles_and_drivers_Feb_2011_1102.pdf.

⁵¹ See 26 IRC 42(j)(4)(A) for information on allowing LIHTC benefits to be carried back one year and carried forward 20 years.

partnership interest to another investor, assuming an investor can be found. Some multi-investor funds offer mechanisms for one investor's shares in a fund to be sold to other investors in the fund.

Banks also should review their needs with respect to CRA consideration.⁵²

Banks considering investments in LIHTCs should take into account their internal capacities. Direct investors should thoroughly understand the LIHTC program, real estate development, and the market for affordable housing in their areas. Investors in LIHTC funds should have sufficient capacity to choose a syndicator, oversee their investments, and understand the basic requirements of the LIHTC program.

Required Investment Management Capacities

Managing risk in LIHTC investments requires expertise and capacity in selecting projects and partners, negotiating agreements, overseeing project development and operations, and ensuring compliance. For banks that are direct investors, these duties often are handled internally. In LIHTC funds, syndicators assist bank investors with these duties.

The general partner of the LIHTC partnership plays a key role in the investment decision. The investor is entering into a 15-year partnership with the general partner, and it is important that the general partner has the capacity and expertise to develop and manage LIHTC properties throughout the life of the investment. The general partner should have a demonstrated track record of successfully developing and managing affordable housing. The general partner should also have the financial capacity to address problems as they arise and depth of expertise to weather staff turnover. Nonprofit general partners, which seldom have significant internal financial resources, may demonstrate an ability to draw on public or philanthropic resources, if needed.⁵³ The general partner must put together strong development teams and should demonstrate the capacity to comply with any regulatory requirements that could affect the flow of tax credits to investors.

LIHTC projects can require special underwriting considerations for loans or investments.⁵⁴ Affordable rent restrictions and tenant income thresholds affect the size of available markets for the units; the cash flow available to cover expenses, fund reserves, and service debt; and the "as is" appraised value of the properties at completion. In higher-cost areas, public entities may be important partners by contributing soft debt to the financing packages to address market uncertainties, or by pledging tenant income subsidies that allow the projects to reach broader markets of tenants. Direct investors should investigate the likelihood that the LIHTCs will flow in the amounts projected and will not be recaptured during the 15-year compliance period.⁵⁵

Syndicators play a key role in LIHTC funds. Investors should perform document reviews of the syndicators and assess their track records. Investors often gather information

⁵² For a variety of resources designed to help banks understand CRA requirements, see www.occ.gov/topics/compliance-bca/cra/index-cra.html.

⁵³ Werwath, Peter, *Financial Underwriting of Low-Income Housing Tax Credit Projects*, Enterprise Community Partners, 2007, www.enterprisecommunity.com/resources/ResourceDetails?ID=19410.doc.

⁵⁴ Various underwriting guidelines are available publicly. For example, see Affordable Housing Investor Council's *AHIC Underwriting Guidelines*, www.ahic.org/tools-resources/.

⁵⁵ Werwath, Peter, *Financial Underwriting of Low-Income Housing Tax Credit Projects*, Enterprise Community Partners, 2007, www.practitionerresources.org/showdoc.html?id=19636&topic=Housing%20Development%20Process&doctype=Spreadsheet.

on the syndicators' management teams, organizational structures, and key capacities. Audited and current unaudited financial statements should be reviewed. Bank investors should understand the syndicators' ability to find and underwrite quality deals in the bank investor's AA, oversight of projects during construction and lease-up, asset management capabilities (including the ability to address problem properties), and the ability to comply with rule and reporting requirements. Investors should understand the syndicators' process of communicating property performance with investors.⁵⁶

Coming out of the financial crisis, there has been a greater interest in understanding the sustainability of syndicators. At issue is whether the syndicator has sufficient resources to continue to operate and manage an existing portfolio of LIHTC properties if the syndicator no longer has new projects (and one-time fees) coming into the fund. Several syndicators reported preparing annual sustainability strategies to address these concerns.⁵⁷

Syndicators often include the underwriting guidelines used for the acquisition of investments in the fund offering documents. These guidelines may include minimum rates of return, debt coverage ratios, and reserves. In some cases, syndicators may be required to inform investors of deviations from these guidelines.

Legal Agreements

Direct investors—or syndicators, in the case of LIHTC funds—are responsible for negotiating rights and responsibilities in the partnership agreement with the general partner. These agreements specify developer guarantees, fee schedules, and reserve requirements. Developers and general partners provide investors with completion, operating, and tax delivery guarantees to mitigate the risk associated with investing in LIHTCs.

An unconditional guarantee of construction completion is the most important factor because an unfinished project cannot produce tax credits. Investors and construction lenders contract with an independent construction inspector to monitor progress and ensure completion in accordance with LIHTC program requirements. Reporting requirements can help mitigate risks, especially reports on any actions or circumstances that affect the value of the asset or the flow of credits to the investors. Investors should be informed of and approve any changes in the development plan or the financing of the project. Investors should be promptly informed of any compliance issues.

Investors should engage legal counsel to review the fund partnership agreement. In addition to the representations and warranties, investors should carefully review the acquisition underwriting guidelines, the reporting requirements, and the controls that the syndicator has over the general partner. The syndicator should be required to approve any actions that can affect the flow of credits to the investor or that affect financing of the property. In addition, the syndicator should be able to change the general partner or the property manager if there is sufficient cause to warrant the action. Investors may also want to consider the protocols on the use of fund-level reserves, including limits on the reserves that syndicators can devote to individual projects.

⁵⁶ Increasingly, syndicators are posting property information securely online, so investors have instant access to up-to-date information.

⁵⁷ If a syndicator is unable to perform its duties, the investors have the ability to replace the syndicator with another third party. This process involves the time and transaction costs of finding and underwriting an appropriate third party and executing the required legal documents.

Asset Management

Most large investors and syndicators maintain extensive asset management and compliance departments. They are particularly diligent during the construction and lease-up period, when the project is most at risk. Investors receive at least quarterly reports on the performance of the projects and review performance metrics such as occupancy levels, debt coverage ratios, cash flows, and compliance levels. Asset management teams perform regular site visits to review the physical properties and the project sponsor's compliance documentation. Portfolio investors and syndicators maintain a watch list of problem properties and institute workout strategies for those that are not performing to industry standards.⁵⁸

Public Welfare Investments

National banks: Under the OCC's public welfare investment (PWI) authority, national banks may make investments in federal LIHTCs and other community and economic development entities and projects that are designed primarily to promote the public welfare, as specified in 12 USC 24(Eleventh) and federal regulation 12 CFR 24. Regulation 12 CFR 24 specifies that a national bank or national bank subsidiary may invest directly or indirectly if the investment primarily benefits low- and moderate-income (LMI) individuals, LMI areas, or other areas targeted by a governmental entity for redevelopment, or if the investment would receive consideration as a "qualified investment" under 12 CFR 25.23 of the CRA. Because LIHTC investments generally meet these criteria, they are considered eligible investments pursuant to PWI regulations.

The regulation prohibits a bank's aggregate PWIs and outstanding commitments, including the proposed investment, from exceeding 15 percent of its capital and surplus. A bank needs written OCC permission, however, if its aggregate investments exceed 5 percent of capital and surplus. Furthermore, a bank's LIHTC and other PWIs under 12 CFR 24 may not expose the bank to unlimited liability.⁵⁹

The regulation requires banks to notify the OCC either through an after-the-fact notification or prior approval request process. The bank completes the CD-1–National Bank Community Development (Part 24) Investments⁶⁰ form to provide information about its PWI investment and submits this information to the OCC's Community Affairs Department.⁶¹

Federal savings associations (FSA): FSAs may make investments in LIHTCs under PWI authorities separate but similar to those of banks.⁶²

⁵⁸ The Affordable Housing Investors Council has published criteria in an effort to establish generally accepted performance standards for the LIHTC industry. Standards have been established for debt coverage ratio, vacancy levels, delinquency rates, and more than 20 other categories. See www.ahic.org/tools-resources/.

⁵⁹ 12 CFR 24.4(b).

⁶⁰ See www.occ.gov/tools-forms/tools/community-affairs/national-bank-part24-investments-pdf.pdf.

⁶¹ Each national bank making a PWI under 12 CFR 24 is required to maintain in its files information adequate to demonstrate that its investments meet the public welfare beneficiary standards and investment limit requirements.

⁶² FSAs are permitted to make PWIs, although FSAs are subject to different investment standards and limits than national banks, 12 CFR 160.36 and 12 CFR 559; see Office of Thrift Supervision, *Community Development Investment Authority: A Guide to the Federal Laws and Regulations Governing Community Development Activities of Savings Associations*, December 1998, www.occ.gov/topics/community-affairs/resource-directories/public-welfare-investments/federal-savings-association-investment-authorities.html.

Accounting Treatment

Under current generally accepted accounting principles, a bank that invests in a qualified affordable housing project (LIHTC project or syndicated LIHTC funds) through a limited partnership investment may account for such investments using one of three primary methods of accounting. The options are: (1) the cost method when significant influence is not present, (2) the equity method when there is significant influence; or (3) the effective yield method when certain conditions are met.⁶³ In addition, the Financial Accounting Standards Board's (FASB) Emerging Issues Task Force (EITF) reached a final consensus related to LIHTC investments on November 14, 2013. The EITF's decision allows an institution to make an accounting policy election to apply a proportional amortization method when certain conditions are met. Guidance was issued in January 2014.⁶⁴ The effective yield method will be allowed only for investments previously accounted for using the effective yield method.

The equity method is currently the most predominant method used for qualified affordable housing projects.⁶⁵

Effective Yield Method

The effective yield method has been preferable for some investors. The effective yield is the internal rate of return on the investment, based on the cost of the investment and the guaranteed tax credits allocated to the investor. Under the effective yield method, the investor recognizes tax credits as they are allocated and amortizes the initial costs of the investment to provide a constant effective yield over the period that tax credits are allocated to investors. The tax credits are recorded as a reduction of income tax expense, and the amount invested to purchase the credits is recorded as amortization expense. Because both the expense and benefit of the credits are recognized "below the line," the risk of distorting operating performance metrics (such as "earnings before interest, taxes, depreciation, and amortization") are reduced.

To qualify for the use of the effective yield method, however, an investor must currently meet all of the following conditions under FASB ASC 323-740-25-1:

- The availability (but not necessary the realization) of the tax credits allocable to the investor is guaranteed by a creditworthy entity through a letter of credit, a tax indemnity agreement, or another similar agreement.
- The investor's projected yield based solely on the cash flows from the guaranteed tax credit is positive.
- The investor is a limited partner in the qualified affordable housing project (the LIHTC project or syndicated LIHTC fund) for both legal and tax purposes and the investor's liability is limited to its capital investment.

⁶³ See the call report instructions under *Equity Method of Accounting and Subsidiaries* section for a more detailed discussion of these accounting methods.

⁶⁴ See FASB's Accounting Standards Update 2014-01.

⁶⁵ Per ASC 970-323, "Real Estate Investments—Equity Method and Joint Ventures," the equity method of accounting for investments in general partnerships is generally appropriate for accounting by limited partners for their investments in limited partnerships. A limited partner's interest may be so minor that the limited partner may have virtually no influence over partnership operating and financial policies. Such a limited partner is, in substance, in the same position with respect to the investment as an investor that owns a minor common stock interest in a corporation, and, accordingly, accounting for the investment using the cost method may be appropriate.

Proportional Amortization Method

The EITF's recent decision allows a bank with LIHTC investments to make an accounting policy election to apply a proportional amortization method when certain conditions are met. An entity must meet all of the following conditions to elect the proportional amortization method:

- It is probable that the tax credits allocable to the investor will be available.
- The investor does not have the ability to exercise significant influence over the operating and financial policies of the limited liability entity, and substantially all of the projected benefits are from tax credits and other tax benefits.
- The investor's projected yield, based solely on the cash flows from the tax credits and other tax benefits, is positive.
- The investor is a limited liability investor in the limited liability entity for both legal and tax purposes, and the investor's liability is limited to its capital investment.

The new accounting guidance should be applied retrospectively to all periods presented when adopted. A reporting entity that uses the effective yield method to account for its investments in qualified affordable housing projects before the date of adoption may continue to apply the effective yield method for those preexisting investments. The new accounting guidance is effective for public business entities for annual periods and interim reporting periods within those annual periods, beginning after December 15, 2014. For all entities other than public business entities, the amendments are effective for annual periods beginning after December 15, 2014, and interim periods within annual reporting periods beginning after December 15, 2015. Early adoption is permitted.⁶⁶

Capital Treatment for LIHTC Investments

National banks and FSAs are subject to minimum risk-based capital requirements calculated under either the general risk-based capital rules or the advanced approaches rules. Under the general risk-based capital rules for national banks, LIHTC investments are risk-weighted at 100 percent. For national banks and FSAs subject to the advanced approaches (Basel II rules), investments in LIHTC partnerships are treated as "equity exposures." Community development⁶⁷ "equity exposures" are assigned a 100 percent risk weight.

Under Basel III rules, as long as investments in LIHTCs are considered equity exposures and they meet the definition of community development equity exposures, they receive 100 percent weight.⁶⁸

V. Who Is in the LIHTC Business Today?

During the past 25 years, a comprehensive infrastructure of public and private organizations has developed to support the growth of successful LIHTC investments.

⁶⁶ See FASB's EITF, *Proposed Accounting Standards Update—Investments—Equity Method and Joint Ventures (Topic 323)*, and *Accounting for Investments in Qualified Affordable Housing Projects*, April 17, 2013.

⁶⁷ A community development equity exposure is defined as an equity exposure that qualifies as a community development investment under 12 USC 24(Eleventh), excluding investments in a small business investment company. The risk-based treatment under the advanced approaches rules is found at 12 CFR 3, appendix C, 52(b)(3).

⁶⁸ 12 CFR 3.52(b)(3)(i); *Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule*, Fed. Reg., vol. 78, no. 198, October 11, 2013.

The LIHTC program was designed to encourage and direct private resources to develop affordable rental housing and to do so sustainably and at scale.

While the LIHTC program was created by federal legislation, a decentralized group of public and private organizations plans, administers, develops, and manages the housing.⁶⁹ While the roles of the participants have been discussed in this report, this section offers additional information.

HCAs

HCAs are state-chartered authorities established to help meet the affordable housing needs of the state's residents. HCAs administer a wide range of affordable housing and community development programs, including tax-exempt housing bonds (mortgage revenue bonds and multifamily housing bonds) and the LIHTC, both of which use federal incentives to leverage private capital for affordable housing. In each state, an HCA administers the LIHTC program and creates a QAP to evaluate project plans and tax credit applications submitted by project sponsors/developers seeking tax credit allocations.⁷⁰ State HCAs may delegate LIHTC allocation authority to local HCAs.

HCAs have responsibilities beyond allocating LIHTCs. Once an LIHTC project is completed and placed in service, the HCA reviews an audited cost certification of project development costs and determines the final eligible basis amount on which LIHTCs may be calculated. The partnership executes a regulatory agreement with the HCA, binding the partnership to the rental restrictions associated with the LIHTC program. The HCA monitors the LIHTC projects over the compliance period, with a particular focus on tenant income eligibility, rents charged, and the condition of the units.

Project Sponsors

Project sponsors identify potential affordable housing projects, put together development teams, gain site control and financing commitments, and apply to local HCAs for allocation of LIHTCs or tax-exempt bond volume caps. Project sponsors serve as general partners or managing members that develop, own, and manage LIHTC projects.

Project sponsors include national, regional, and local real estate development organizations. They can be for-profit or nonprofit organizations. Under all state QAPs, a minimum of 10 percent of tax credit allocations is set aside for nonprofit developers.⁷¹

Investors

As discussed in detail in previous sections of the report, LIHTC investors can be either individuals or corporations, although because of the tax treatment for passive losses,

⁶⁹ The federal government has adjusted its regulations and guidance implementing the LIHTC program in response to concerns with issues affecting the operation of the program. The IRS has been heavily involved in efforts to improve the program's efficiency and the strength of the market for LIHTCs. During the financial crisis of 2008, HUD initiated a number of measures to stabilize the market for credits. HUD also provides rental subsidies that help make LIHTC housing in reach of households with very low incomes.

⁷⁰ State HCAs may delegate authority to local HCAs to issue tax credits, subject to the state's annual per capita cap.

⁷¹ 26 IRC 42(h)(5).

most tax credit investors are widely held C-corporations.⁷² Industry experts estimate that 85 percent of the \$9.5 billion in equity from corporate investors used to finance LIHTC projects in 2012 came from the banking sector.⁷³

Syndicators

Syndicators perform a critical role in bringing together investors and project sponsors. They often act as intermediaries and provide additional financing tools and technical assistance to project sponsors. Syndicators use pooled funds to invest in numerous LIHTC projects. They perform the necessary due diligence to identify affordable housing investment opportunities, and they monitor the construction and oversee ongoing compliance of the properties on behalf of the investors. Before investing, banks should carefully underwrite syndicators to ensure that the syndicators' activities are conducted in a safe and sound manner and in accordance with all applicable laws. A bank's relationship with a syndicator should be guided by the same risk management, security, privacy, and other consumer protection policies the bank uses when conducting activities directly.

There is a robust market of LIHTC syndicators. Some are nonprofit organizations, including national nonprofits, such as the National Equity Fund or Enterprise Community Investment, or regional funds, such as those that are members of the National Association of State and Local Equity Funds. Other syndicators are for-profit organizations. See appendix F for more information on LIHTC investors.

Lenders

In addition to the tax credit equity, LIHTC projects often require debt financing. Loans can be conventional or government-insured (Federal Housing Administration) products,⁷⁴ or "gap financing" provided by state and local governments or other third parties. This gap financing goes into a project as "soft loans," for which payment is due only when there is sufficient cash flow. Appendixes A and B contain hypothetical transactions that illustrate how debt and tax credit equity are used to finance affordable housing projects.

LIHTC projects often require specialized financial products. Because much of the equity is invested after the properties are placed in service, bridge and construction loans are required through the construction period. Banks may provide letters of credit to enhance the creditworthiness of the tax-exempt private activity bonds used in 4 percent LIHTC transactions. They may also underwrite and market the tax-exempt private bond activity issues.

In some markets, lenders have formed consortia to provide debt financing for LIHTC projects. Funds from multiple banks are pooled and then lent to various LIHTC projects. This structure allows smaller lenders to participate in the transactions and reduces the risk for any individual investor. Some of these lending consortia have developed through state banking associations.⁷⁵

⁷² Generally, S corporations are not subject to tax at the corporate level. Instead, the tax credits and other tax benefits are passed through to the shareholders and are taxed at the individual shareholder level. When marketing LIHTC projects to S corporations, project owners must look through to the shareholders and assess whether they can use the LIHTC. *Low-Income Housing Tax Credit Handbook*, Novogradac, section 2:14, 2011.

⁷³ *The Community Reinvestment Act and Its Effect on Housing Tax Credit Pricing*, CohnReznick, May 2013.

⁷⁴ For information on the FHA Housing Tax Credit Pilot Program, see http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/mfh/map/maphome/taxcredit. It is intended to streamline FHA processing of mortgage insurance applications for projects with equity from the LIHTC program.

⁷⁵ For more information, please see the Center for Community Lending, www.centercommunitylending.org, or the Association for Reinvestment Consortia for Housing.

Third-Party Experts

The LIHTC field has evolved to include an extensive resource of professional third-party experts on the use of LIHTCs. This expertise includes assistance in project review, underwriting, and legal and accounting assistance. In addition, numerous trade associations work to develop industry standards, promote transparency, and advocate on behalf of tenants, project sponsors, and investors with federal and state governments. See appendix F for a list of trade associations and other third-party resources.

VI. How Does the Cost or Pricing Structure of LIHTCs Work?

LIHTC investors receive financial benefits on their investments through the credits they are able to take against their federal income tax liability, as well as the additional deductions from real estate losses. Bank investors may also receive favorable CRA consideration of LIHTC investments.

Understanding the returns of LIHTC transactions involves understanding transaction costs and the timing of costs and benefits.⁷⁶ For investors, the financial return on their investments is maximized when equity is invested at the time the properties are placed in service, and the tax credits can be claimed.⁷⁷ The tax benefits are realized over the next 10 to 15 years. Given the time value of money, the investor expects the financial return on an LIHTC investment over 10 years to exceed the price paid for the investment. Because the tax credit benefit is fixed, the investor invests an amount less than the expected benefit from the tax credits and real estate losses. The amount invested, relative to the amount of tax credits, is referred to as the “price” paid for the credit. Industry professionals note that other factors that may affect this price include the perceived risk associated with the investment, the competition among investors for individual projects, the ability to use the effective yield method to account for LIHTC investments,⁷⁸ the amount of tax losses, and the CRA.⁷⁹

Historically, the price paid for LIHTCs has varied considerably. As shown in figure 3, yields on LIHTC investments exceed the after-tax, 10-year U.S. Treasury yields. The difference in yields varies largely due to variations in LIHTC demand. Transactions early in the program’s history reflect a great deal of uncertainty about the tax credit. Over time, as investors became more comfortable with LIHTCs, the industry became much more standardized and predictable. Prices became much more competitive and were relatively stable from 2000 through 2004.

In 2005, yields dropped as Fannie Mae and Freddie Mac substantively increased their investments. In 2008, yields rose (and the price paid for LIHTCs fell) significantly as Fannie Mae and Freddie Mac were placed into conservatorship and were no longer active in the market. In addition, the financial crisis affected bank profitability, which

⁷⁶ Appendix C offers an example pay-in schedule.

⁷⁷ In contrast, project sponsors/developers prefer to receive equity contributions earlier in transactions, to reduce borrowing costs.

⁷⁸ “Do Firms Incur Costs to Avoid Reducing Pre-Tax Earnings? Evidence from the Accounting for Low-Income Housing Tax Credits,” Robinson, Leslie A., *Accounting Review*, vol. 85, no. 2, pages 637–669.

⁷⁹ Understanding the relative impact of these factors on the price of housing credits has been a challenge for the industry. *The Community Reinvestment Act’s Impact on Housing Tax Credit Pricing*, CohnReznick, May 2013, found that “the largest single determinant of housing tax credit pricing is based on the CRA investment test value of a given property’s location.” The U.S. Government Accountability Office, in the *Community Reinvestment Act: Challenges in Quantifying its effect on Low-Income Housing Tax Credit Investment*, August 28, 2012, found that “quantifying the extent of any effect of CRA on LIHTC equity contributions is difficult given data and methodological challenges.”

also affected demand for LIHTCs. In 2008 and 2009, Congress authorized several efforts to help stabilize the market and keep existing projects moving forward.⁸⁰ By the end of 2010, the LIHTC market rebounded with a more diverse investor market.

Investors incur costs in underwriting their investments, whether the investments are made directly or through a multi-investor equity fund. After the affordable housing projects are financed, investors have management costs associated with monitoring the performance of the properties and addressing any problems that might arise.

Investors can obtain guarantees on investment yields through agreements with third-party guarantors. For a fee, these guarantors fund shortfalls in expected returns. In addition, investors can negotiate so-called tax credit adjusters with the general or managing partners of project partnerships, so investors can reduce their anticipated capital contributions in the event that the general partner fails to meet certain benchmarks that affect the amount or timing of the tax credits.⁸¹ These tax credit adjusters help LIHTC investors achieve their projected yields.⁸²

VII. What Barriers Have Constrained the Growth in the Use of LIHTCs?

Restrictions on the Supply of LIHTCs and Private Activity Bonds Available

The supply of 9 percent credits available each year is limited. While the demand among investors for LIHTCs dropped during the financial crisis, by 2010, the demand once again outstripped LIHTC supply. In some high-demand areas, LIHTC-financed projects have been consistently oversubscribed. Increased competition for tax credits raises the price for credits and lowers the yield, which in turn has reduced the number and range of investors in the market. While the supply of 4 percent credits is not similarly constrained, the availability of private activity bonds is subject to volume caps and is therefore a limiting factor in 4 percent transactions.

Length of Investment Period

LIHTCs require a long-term, 15-year commitment by investors. Some investors may be reluctant to enter this business if they need to maintain short-term liquidity, or if they have concerns about their needs for federal tax credits over the entire credit period.

⁸⁰ HERA contains numerous LIHTC program provisions, and the American Recovery and Reinvestment Act of 2009 authorized two temporary programs (the Tax Credit Assistance Program and the Tax Credit Exchange Program) to help keep the pipeline of projects moving despite the weakened demand among investors during this period.

⁸¹ *Housing Tax Credit Investments, Adjusters, and Timing*, Stonehouse, Jill, Affordable Housing Finance, October 2007, www.housingfinance.com/economic-development/housing-tax-credit-investments--adjusters--andtiming.aspx. Basis adjuster provisions adjust the overall amount of investor equity based on the amount of credits expected. Timing adjusters adjust investor equity for delays in benefit delivery that may result from construction or lease-up periods that exceed initial expectations.

⁸² Memorandum from Joseph Urban, Acting Director, Exempt Organizations Rulings and Agreements, Internal Revenue Service, on Low Income Housing Tax Credit Limited Partnerships, April 25, 2006, www.novoco.com/low_income_housing/news/archives/resource_files/UrbanMemo42406.pdf.

Size of Investments

Minimum investment amounts for LIHTC funds often start at about \$1 million for multi-investor funds. Minimum amounts for direct investments can be much higher. This can be a barrier for smaller community banks, especially those with limited federal tax liabilities. Some regional LIHTC equity funds have lowered their minimum investment to \$250,000 and have been very successful in attracting new investors, especially community banks.

Market Transparency

The market for LIHTC investments is not well publicized. Housing financed with LIHTCs tends to attract sophisticated investors with a strong understanding of real estate development. Because of the complexity of the benefits, it can be difficult to compare how different investors are pricing risks and rewards.

Transaction Complexity

The LIHTC is an important program for addressing the nation's affordable housing needs; however, the transactions can be quite complex with regard to substantial regulatory, financial, and tax issues. While a direct investment into an LIHTC project can be challenging for a new investor, investments in multi-investor equity funds can often be a more appropriate starting point, especially for smaller banks. In addition, as the industry has developed, there are now a considerable number of public- and private-sector organizations that can assist new investors. While each transaction is unique, each transaction is structured on a foundation of industry standardization and experience.

VIII. Conclusion

The LIHTC is an important resource in the development of affordable rental housing. Since 1987, when the LIHTC program was first authorized, more than 2.4 million affordable rental housing units have been developed using the tax credits. Banks can invest in LIHTCs either directly or through syndicated funds. In addition, banks can participate as lenders with short- or long-term financing products.

Since 1987, the LIHTC industry has developed a sophisticated array of resources to help new and experienced participants effectively identify and manage the risks inherent in project financing. National, regional, and community banks have made important investments in their communities using LIHTC. By investing in or lending to LIHTC-financed projects, banks have met the needs of their customers and communities. In the process, banks have earned competitive rates of return and favorable CRA consideration.

Appendix A

Hypothetical Case Study: 9 Percent LIHTC Project With Basis Boost

Project size: Total project development cost is \$15,220,000.

Project overview: This sample transaction illustrates a direct investment by a bank in a 9 percent LIHTC-financed project located in a DDA. Because the project is in a DDA, the eligible basis is boosted by 30 percent. The project involves the new construction of 100 units of affordable rental housing. The units are allocated to renters according to their household income relative to the area median income (AMI), as shown in table 2.

Table 2: Affordable Unit Allocations

No. of units	Household description
10	Households with income under 60% AMI
20	Households with income under 50% AMI
34	Households with income under 40% AMI
36	Households with income under 30% AMI

Tax credit project financing: Table 4 illustrates how the number of tax credits available to the project is calculated. The eligible basis was “boosted” because of the project’s location in a DDA. Because all of the units are affordable, 100 percent of the adjusted eligible basis becomes the qualified basis. Multiplying the qualified basis by the applicable percentage gives us the number of tax credits available annually.

In this example, a bank became a direct investor with 99.99 percent ownership interest in the partnership developing the properties. As shown in table 3 that investment created \$13,162,500 in equity financing (the bank paid \$0.90 for every \$1 of credit). The remainder of the financing came from a first lien note from a state housing trust fund program of \$1,056,200. The balance of financing needed to complete the project was made by other state housing programs providing “soft” financing to close the gap. In this case, the second and third mortgages are to be repaid upon transfer of the properties or after 30 years, whichever comes first.

Table 3: Sources and Uses of Funds

Sources of funds	Amount
Equity (sale of 9 percent LIHTCs)	\$13,162,500
Permanent loan (state housing trust fund program)	1,056,200
Second mortgage (state housing program loan)	500,000
Third mortgage (state housing development corporation)	500,000
General partner equity	1,300
Total sources of funds	\$15,220,000
Uses of funds	Amount
Land costs	\$400,000
Construction costs	10,411,178
Soft costs	2,852,008
Developer’s fee	1,556,814
Total development costs	\$15,220,000

Table 4: Equity Calculation

Factor	Amount
Eligible basis ^a	\$12,500,000
Basis boost for DDA	130%
Eligible basis adjusted for DDA	\$16,250,000
Applicable fraction (percentage of affordable units)	100%
Qualified basis	\$16,250,000
Applicable percentage	9%
Annual housing tax credits (Qualified basis with basis boost multiplied by the actual tax credit rate applied to this project, 9.0)	1,462,500
Total housing tax credits (Annual housing tax credits x 10 years)	14,625,000
Net equity (Total credits x \$0.90 (price per tax dollar))	\$ 13,162,500

^a The eligible basis refers to the construction costs that can be included in the LIHTC calculations. The eligible basis includes most hard costs, such as construction costs, and most depreciable soft costs. Excluded are land, commercial space, and any portion of professional fees (such as consultant or developer fees) that are above state-determined limits.

Appendix B

Hypothetical Case Study: 4 Percent LIHTC Project

Project size: Total project development cost is \$16,207,635.

Project overview: The project is an example of a direct investment by a bank in a 4 percent LIHTC project financed with tax-exempt private activity bonds. The project involves the new construction of 128 affordable rental units. The project sponsors commit to set aside 40 percent of the units at or below 60 percent of the AMI, and 100 percent of the units to those at or below 60 percent of AMI.

Tax credit project financing: The tax credits available to this project are calculated in table 6. In this example, a bank invests in a partnership that used 4 percent LIHTC allocations to provide \$3,687,340 in equity financing for the construction of this low-income housing project. Just over half of the financing of the project, \$8,265,894, was from the sale of tax-exempt private activity bonds.

Table 5: Sources and Uses of Funds

Sources of funds	Amount
Equity (sale of 4% LIHTCs)	\$ 3,687,336
Permanent debt (bond)	8,265,894
Soft debt	3,089,110
Developer's fee note	1,165,295
Total sources of funds	\$16,207,635
Uses of funds	Amount
Land costs	\$ 2,600,000
Construction costs	9,312,000
Soft costs	2,934,255
Developer's fee	1,361,380
Total development costs	\$16,207,635

Table 6: Equity Calculation

Factor	Amount
Eligible basis ^a	\$12,803,265
Applicable fraction (percentage of affordable units)	100%
Qualified basis	\$12,803,265
Applicable percentage ^b	3.20%
Annual housing tax credits	409,704
Total housing tax credits (Annual housing tax credits x 10 years)	4,097,040
Net equity (Total housing tax credits x \$0.90 (price per tax dollar))	\$ 3,687,336

^a The eligible basis refers to the construction costs that can be included in the LIHTC calculations. The eligible basis includes most hard costs, such as construction costs, and most depreciable soft costs. Excluded are land, commercial space, and any portion of professional fees (such as consultant or developer fees) that are above state-determined limits.

^b For buildings that are placed in service after 1987, the 4 percent credit is recalculated on a monthly basis to yield a present value of 30 percent of the costs that qualify for the credit. The IRS publishes these rates at <http://apps.irs.gov/app/picklist/list/federalRates.html>.

Appendix C

Hypothetical Pay-In Schedule for Equity

Table 7 illustrates how equity, \$10 million in this direct investment example, may be disbursed into an LIHTC project. Pay-in schedules are a negotiation between the investor or limited partner and the general partner or managing member. Pay-in schedules reflect the unique circumstances of each project, the requirements of investors in partnerships and the needs of the general partner or managing member.

Table 7: Equity Pay-In Schedule

Milestone (in percent of total equity)		Amount
30%	Date of closing	\$3,000,000
40%	Placed in service (completion of occupancy certification)	4,000,000
20%	Occupancy at 90% and cost certification completed	2,000,000
10%	Federal tax return and Schedule K-1 ^a submitted	1,000,000
100%	Equity	\$10,000,000

^aThe IRS Schedule K-1 (Form 1065) describes the partner's share of income, deductions, credits, etc.

Appendix D

Hypothetical Case Study: Investing in an LIHTC Fund

Typical investment amount: \$1 million

Minimum investment amount: \$250,000

Fund description: Community Fund X is a \$10 million multi-investor LIHTC fund. The fund makes equity investments in several CRA eligible affordable housing LIHTC projects within a specified state. The fund investment is projecting a 9 percent pre-tax equivalent and 6 percent after-tax yield. This tax-advantaged investment generates its return based on the delivery of federal tax credits (LIHTC) and taxable losses that are calculated based on a 35 percent corporate tax rate.

By offering a \$250,000 minimum investment, Community Fund X becomes a viable option for community banks wishing to participate and receive a return on their investment and CRA credit consideration.

The risks associated with investment in LIHTC funds is the continuation of program compliance to ensure federal tax credit and loss delivery. A financially strong and experienced fund manager is a crucial consideration when investing in a LIHTC fund.

Community Fund X is managed by a respected nonprofit regional tax credit syndicator. The fund manager has 20 years of experience in LIHTC syndication, has a strong balance sheet, and has an experienced management team. Asset and risk management are essential departments. Although there are more than 30 funds and 500 affordable housing LIHTC properties, the fund manager has never experienced a loss of tax credits due to foreclosure.

Table 8: Multi-Investor Fund Investment

Year	Investor pay-ins	LIHTC	Taxable loss	Tax savings 35%	Total annual benefit	Net annual benefit
1	\$ 186,161		\$ (2,714)	\$ 950	\$ 950	\$ (185,211)
2	712,194	24,368	(39,816)	13,936	38,304	(673,890)
3	35,230	96,945	(73,365)	25,678	122,623	87,393
4	27,553	106,107	(57,545)	20,141	126,248	98,695
5	4,310	106,107	(49,645)	17,376	123,483	119,173
6	4,310	106,107	(48,250)	16,888	122,995	118,685
7	4,310	106,107	(45,832)	16,041	122,148	117,838
8	4,310	106,107	(38,221)	13,377	119,484	115,174
9	4,310	106,107	(38,301)	13,405	119,512	115,202
10	4,310	106,107	(39,481)	13,818	119,925	115,615
11	2,167	106,107	(39,650)	13,878	119,985	117,818
12	2,167	81,739	(39,822)	13,938	95,677	93,510
13	2,167	9,162	(40,002)	14,001	23,163	20,996
14	2,167		(40,263)	14,092	14,092	11,925
15	2,167		(40,561)	14,196	14,196	12,029
16	2,167		(39,631)	13,871	13,871	11,704
17			(33,882)	11,859	11,859	11,859
18			(28,173)	9,861	9,861	9,861
19			(264,846)	92,696	92,696	92,696
Total	\$1,000,000	\$1,061,070	\$(1,000,000)	\$350,000	\$1,411,070	\$411,070

Investor pay-ins: This column in table 8 represents the gross proceeds of the investment in four units at \$250,000 per unit. Typical use of proceeds is as follows: investment in operating partnership of 88.75 percent; payment of acquisition fees of 7.50 percent; payment of a working capital reserve of 3.25 percent, which is paid annually; and the payment of an organization and offering expense of 0.50 percent.

LIHTC: This is the total number of LIHTCs generated from the various affordable housing investments made by the fund. The tax credits are earned over 10 years of the 15-year compliance period.

Taxable loss: This is the total consolidated taxable losses generated from the various affordable housing investments and the management of the fund.

Tax savings (35 percent): The tax savings is the imputed tax benefit based on the taxable losses at a 35 percent corporate tax rate.

Total annual benefit: This represents the total number of LIHTCs and the tax-savings benefit.

Net annual benefit: This represents the net of investor pay-ins and the total annual benefit for the investment.

Appendix E

Abbreviations

AFR	applicable federal rate
AHIC	Affordable Housing Investors Council
AMI	area median income
ASC	accounting standards codification
CFR	Code of Federal Regulations
CRA	Community Reinvestment Act
DDA	difficult development area
EITF	Emerging Issues Task Force
FASB	Federal Accounting Standards Board
FHA	Federal Housing Administration
FSA	federal savings association
GP	general partner
HCA	housing credit agency
HCDA	Housing and Community Development Act of 1974
HERA	Housing and Economic Recovery Act of 2008
HOLA	Home Owners Loan Act of 1933
HR	House of Representatives
HTC	historic tax credits
HUD	U.S. Department of Housing and Urban Development
IRC	Internal Revenue Code
IRS	Internal Revenue Service
LIHTC	low-income housing tax credit
LLC	limited liability company
LP	limited partner
PHA	public housing authority
PWI	public welfare investment
QAP	qualified allocation plan
QCT	qualified census tract
RETC	renewable energy tax credits
USC	U.S. Code

Appendix F

Resource Directory

OCC Community Affairs

“Low-Income Housing Tax Credits,” *Community Developments Fact Sheet*, August 2013
www.occ.gov/topics/community-affairs/publications/fact-sheets/fact-sheet-low-income-housing-tax-credits.pdf

“Low-Income Housing Tax Credit Funds: Investment Opportunities for Banks,” OCC Web and Telephone Seminar, September 10, 2008

- Executive summary: www.occ.gov/topics/community-affairs/resource-directories/tax-credits/lihtc-wc-final-exe-summary.pdf
- PowerPoint slide presentation: www.occ.gov/topics/community-affairs/resource-directories/tax-credits/lihtc-wc-final-handouts-slides.pdf

“Investing in Low-Income Housing Tax Credits: A Sound Opportunity for Community Banks,” *Community Developments Investments*, spring 2006
www.occ.gov/static/community-affairs/community-developments-investments/Spring06/index.htm

Tax Credits Resource Directory

www.occ.gov/topics/community-affairs/resource-directories/tax-credits/index-tax-credits.html

CRA

www.occ.gov/topics/compliance-bsa/cra/index-cra.html

Public Welfare Investments Web Resource Directory

www.occ.gov/topics/community-affairs/resource-directories/public-welfare-investments/index-public-welfare-investments.html

HUD

LIHTC Basics

www.hud.gov/offices/cpd/affordablehousing/training/web/lihtc/basics/

LIHTC Project Database

www.huduser.org/portal/datasets/lihtc.html

IRS

Section 42

www.novoco.com/low_income_housing/lihtc/irs_guidance.php#irs_code42

Tax-Exempt Bonds

www.irs.gov/taxexemptbond/index.html

Affordable Housing Investors Council

www.ahic.org

CohnReznick

www.cohnreznick.com/industries/affordable-housing

Federal Accounting Standards Board

www.fas.org/home

Housing Advisory Group

www.housingadvisorygroup.org

LIHTC Working Group

www.lihtcworkinggroup.com

National Association of Home Builders

www.nahb.org/page.aspx/category/sectionID=1921

National Association of Local Housing Finance Agencies

www.nalhfa.org

National Association of State and Local Equity Funds

www.naslef.org

National Council of State Housing Agencies

www.ncsha.org

National Low Income Housing Coalition

www.nlihc.org

Novogradac Affordable Housing Resource Center

www.novoco.com/low_income_housing/index.php

David Black was the primary author of this updated report. Sherrie L.W. Rhine was the primary author of the original report published in February 2008. Also contributing were William Reeves and Barry Wides. *Community Development Insights* reports differ from OCC advisory letters, bulletins, and regulations in that *Insights* reports do not reflect agency policy and should not be considered as regulatory or supervisory guidance. The information used in this report was obtained from publicly available sources considered to be reliable. The use of this information, however, does not constitute an endorsement of its accuracy by the OCC.

The Tax Cuts and Jobs Act (Pub. L. No. 115-97), signed into law on December 22, 2017, made numerous changes to the Internal Revenue Code. This document has NOT been updated to reflect these changes. Banks or other entities considering a tax credit equity transaction should consult with a tax professional with knowledge of how the changes in the tax code may affect specific tax credit equity transactions.

