

# Intermediate Boot Camp for HFCs

## Outline

### Multifamily Housing

What are your financing tools?

1. Housing Tax Credits – 9% and 4%
  - How does an HFC participate, as a
    - Bond Issuer
    - Developer
    - General Partner
    - Lender (Short Term for Local Govt points)
  
2. Gap Financing
  - HOME
  - CDBG
  - AHP

### Single Family Housing

1. Mortgage Revenue Bond Program
  
2. Mortgage Credit Certificates
  
3. Infill Building
  - a. Getting a city/county to give property to HFC for Development
  - b. Putting a house back on the tax roles

## **INTERMEDIATE**

### **Program Development/Administration – How do you do it?**

#### Examples

In-fill building.

Getting a city or community to give property to the HFC for development.

Putting a house back on the tax rolls

Local Funding – 9% Housing Tax Credit projects

Unique Programs

### **Partnerships**

Project Specific Corporations

501c3 (?)

### **Program Details**

Mortgage Revenue Bond Program

Multi-Family Bond Programs, 4% Tax Credits

Participation in local financing for Housing Tax Credit projects

Mortgage Credit Certificates

Participation with local or State government in CDBG, HOME

Acquisition/Development of Affordable Housing, both single and multifamily.

State Programs

Community Outreach



# Housing Tax Credits

Texas Department of Housing & Community Affairs

## ***What is the Housing Tax Credit (HTC) Program?***

In 1986, through a re-writing of the Tax Code, Congress rescinded a host of real estate incentives previously available to developers of affordable housing. However, in an effort to encourage the continued production of low income housing, Congress replaced those incentives with tax credits for “affordable” housing projects. Credits are usable by owners of these affordable housing projects to reduce —dollar for dollar — their federal income tax obligations. The amount of credit awarded to a housing development is based on both the cost of the development and the percentage of low-income units in the development. As the nation’s largest financing vehicle for affordable housing, the Housing Tax Credit program has produced almost 2.5 million affordable housing units since its inception.

Between 1986 and 1992, the Low Income Housing Tax Credit (LIHTC) program was authorized only on a temporary basis. In 1993, however, Congress made LIHTC a permanent program. The program is administered *not* by HUD, but by the Department of the Treasury and the Internal Revenue Service. In terms of number of units developed each year, LIHTC is the largest federal housing program in existence. In 2005, Texas Department of Housing & Community Affairs removed “Low Income” from the title of the program.

## ***How much equity can be raised using Tax Credits?***

The equity that an investor brings to a housing project typically equals between 50 and 70 percent of the value of the project. This means that a developer must still rely on debt financing to develop the project. That debt financing generally takes two forms: 1) a first mortgage loan (usually at market rate interest and payable out of the project’s rental income), and 2) deferred developer’s fees.

## ***How is a partnership typically structured?***

In order to allow the flow of the tax credits to investors, the ownership is structured in the form of a limited partnership. Usually, the general partner will have a 0.01% interest and the limited partners (the investors) will have 99.99%. This allows the limited partners to get the major share of the tax credits, while making them liable only for the capital which they have committed to the project. The general partner assumes liability and total management of the property.

## ***What type of housing may be built using Tax Credits?***

Both scattered site housing and traditional apartment complexes are eligible to receive credits. Generally, each housing unit must contain its own living, cooking, dining, and bathroom facilities. The program does make an exception, however, for single room occupancy (SRO) projects, which typically have shared kitchen and bathroom facilities, and for congregate housing designed for elderly and

disabled individuals. Provided that certain conditions are met, transitional housing for the homeless is also allowed.

To qualify for tax credits, a developer must set aside a certain portion of units for low-income tenants. A developer must elect one of two “set aside” thresholds: the “20-50” or the “40-60” test.

- *The “20-50” test* requires that 20% or more of the residential units be rented to tenants with incomes at or below 50% of an area’s median gross income.
- *The “40-60” test* requires that 40% or more of the project’s residential units be rented to tenants with incomes at or below 60% of an area’s median gross income.

### ***Who are the potential residents?***

Depending on which set aside threshold is elected, the residents will be people with incomes up to 50 or 60 percent of an area’s median gross income. Since the tax credit program does not have rental subsidies, the potential residents are frequently persons on an hourly wage or in entry-level employment positions. Projects may be geared toward special classes of residents, such as elderly persons or persons with disabilities. It is important to note, however, that projects developed under HTC have a narrower band of affordability than those previously developed under HUD’s Section 8 rental assistance program. Unlike the Section 8 rental assistance program, there is no deep subsidy to assist residents in paying their rents. This means that the established rent for a unit is the actual rent the resident must pay — even if that amount far exceeds 30% of income. Consequently, the band of affordability is usually considered to be 40 to 60% of a community’s median income.

### ***How are rents assessed?***

The maximum rent that can be charged for a low-income unit is called the gross rent. The gross rent cannot exceed 30% of the published income limit for a qualified household. If an area’s median income goes down, and the owner has adopted “floor” rents, the owner is not required to lower the rent charged to residents. On the other hand, if an area’s median rent goes up, the owner may increase the rent on the tax credit units accordingly.

Supportive services for elderly housing projects and congregate care facilities are allowed under the Tax Credit program. However, charges for any services that are *not optional* to low-income residents must be included in gross rent. (This means that any mandatory charges, such as for laundry or meals or support services, must be counted as part of the residents’ gross rent.) Utilities, also, must be counted as part of the gross rent.

*The following example demonstrates the calculation of maximum rent for a two-bedroom apartment under the 60% set aside rule.*

For the purpose of rent calculation, it is assumed that each bedroom has 1.5 inhabitants. For a two-bedroom apartment, the rent must be based on assumed occupancy by a three-person family. If the median income for a three-person family in a specific geographic area is \$30,000, 60% of this amount is \$18,000. The rent for the unit would be calculated as follows:

Imputed income at 60% of area median	\$18,000
Multiplied by	x 30%
Maximum Annual Rent	\$5,400
Divided by (months)	÷ 12
Maximum Monthly Rent	\$450

Note that the maximum rent must include utilities. If residents are required to pay their own utilities, you must further adjust for a utility allowance. It is important to remember that this is the rent that *all* families will pay for a two-bedroom unit, regardless of family size or actual household income, although if household income exceeds 60% of median (\$18,000 in this example), the family would not qualify for residency.

#### ***What is the maximum credit available for an eligible housing project?***

A housing project can receive an annual tax credit of up to 9% of a building's "qualified basis." The qualified basis is that fraction of a building which is occupied by low-income residents (either in terms of housing units or square footage — whichever is lower) *multiplied by* eligible project costs. Land costs and any other non-depreciable costs are *ineligible* costs for the purposes of receiving tax credits.

The following two types of credits are available:

- *Nine Percent Credit* - for cost of a new building or substantial rehabilitation without a federal subsidy
- *Four Percent Credit* - for cost of a new building or substantial rehab built *with* private activity bonds, which are considered to be a federal subsidy

Until July 30, 2008, the nine and four percent credit figures were approximate since they varied slightly with the changes in interest rates. As part of the Housing Stimulus Bill, however, the Congress fixed the 9% credit at 9% for projects placed in service by December 31, 2013; the 4% credit continues to float. Once a project owner receives an allocation of credits, the owner can claim that amount in tax credits annually for 10 years.

A building "*with federal subsidy*" is one in which the construction or rehab is financed with tax-exempt bond proceeds. Although this previously included HOME funds as well, the Housing Stimulus Bill clarified that HOME funds are not a federal subsidy and should receive the same exception as Community Development Block Grants.

***How do you apply for Tax Credits/How are they awarded?***

Although the rules for the tax credit program are developed by the IRS, the program is operated at the state government level. Each state is allowed to develop its own program priorities within the overall parameters for the program. These priorities are published by each state as its Qualified Allocation Plan (QAP). States also determine the timeframe under which they will accept proposals and the contents of these proposals.

Each application is reviewed and scored according to the state's tax credit allocation plan. Selection criteria may include: project location, project characteristics, sponsor characteristics, participation of local tax-exempt organizations, public housing waiting lists, and other criteria selected by the state. Those projects meeting the state's criteria, and for which the state has sufficient Credit Authority, will be awarded a Reservation of Credit Authority.

Each state has a limited amount of credits to be allocated each year, as adjusted by inflation. In 2011, that amount was determined by multiplying \$2.15 by the state's population. Congress has mandated that at least 10% of a state's tax credit allocation go to nonprofit organizations. In addition to this nonprofit allocation "preference," some states establish other preferences or set-asides, such as for special needs housing, SROs, or projects in rural areas.

The amount of credit awarded to each project will be the *lesser* of the maximum credit allowable (9% or 4%) or an amount necessary to support the project's viability as affordable housing. As a condition of the award, the recipient must 1) expend at least 10% of the anticipated costs of the project within a year of the date by which the allocation is made (or such shorter period as required by the State); and 2) place the building in service by the end of the second calendar year following the year of the allocation.

In the State of Texas, the Housing Tax Credit Program is administered by the Texas Department of Housing and Community Affairs (TDHCA). Each of the State's thirteen regions receives an allocation based on a formula that recognizes population and housing needs, further allocated between rural and urban/exurban areas. In its Qualified Allocation Plan for 2011, TDHCA established funding set-asides for nonprofit sponsored applications (10%) and preservation of "at risk" housing (15%). Preapplications for 2012 funding will be due in January 10, 2012, with final applications due on March, 1 2012. Awards will be announced at the end of July 2012.

For further information, you can visit the TDHCA website at [www.tdhca.state.tx.us](http://www.tdhca.state.tx.us).

## **RESOURCES FOR GAP FINANCING**

### **Affordable Housing Program ( Federal Home Loan Bank)**

#### ***What is the Federal Home Loan Bank?***

The Federal Home Loan Bank System was created in 1932 to ensure a stable supply of funds for mortgage finance and to encourage the sound and economical financing of housing and other community needs. The twelve regional Federal Home Loan Banks (FHL Banks) within the system carry out this role by linking local financial institutions with the capital markets. All FHL Banks are wholly owned by member financial institutions engaged in housing finance activities. Stockholder institutions receive quarterly dividends on their capital stock investment from the FHL Banks' earnings.

#### ***What is the purpose of the Federal Home Loan Bank System?***

Although the Federal Home Loan Bank System has had varying responsibilities in the past, since 1989 its primary function has been to act as a stable source of funds for mortgage lenders. The FHL Banks accomplish this mission by providing member institutions — local banks — with inexpensive capital. This means that local banks which are members of the FHL Bank System can borrow money from their regional or district banks at low rates, and then pass on those savings to individual borrowers. The FHL Bank System also operates two programs encourage the development of affordable housing. One of these programs is the Affordable Housing Program (AHP).

#### ***What is the Affordable Housing Program?***

The Affordable Housing Program provides the opportunity for nonprofit and for-profit housing sponsors to obtain either direct subsidies or low interest loans to develop affordable housing. AHP funds may be used either to:

- Finance the purchase, construction, and/or rehabilitation of owner-occupied housing for families with incomes at or below 80 percent of median income, or
- Finance the purchase, construction, or rehabilitation of rental housing in which at least 20 percent of the units are occupied *by* and affordable *to* households with incomes at or below 50 percent of the median income.

Applications for funding are evaluated according to criteria established by the program and change from year to year.

#### ***How much funding is available?***

Currently, ten percent of the FHL Banks' net income for the previous year will be available for this program. Stockholders must meet standard collateral and prepayment requirements. They may charge borrowers their normal fees and points and use standard underwriting guidelines. Applications that show flexible underwriting and lowered fees are generally given more favorable consideration. Loans for multi-family rental developments will be monitored by the bank annually to ensure compliance with program guidelines.

#### ***How to apply.***

A housing sponsor must apply for AHP funding through a member bank. The FHLB's regional offices provide listings of member banks. Applications are generally accepted twice a year – in

the spring and in the fall – although the FHLB regions have the right to establish different funding cycles if they wish. Additionally, member banks may set their own application deadlines prior to FHLB deadlines.

### **HOME Investment Partnerships Program (HOME)**

#### ***What is the HOME Program?***

HOME is a federally-funded housing program enacted in 1990 as part of the National Affordable Housing Act (NAHA). The HOME program is intended to foster partnerships among federal, state, and local governments and the private sector, including both for-profit and nonprofit developers of affordable housing.

#### ***What are the objectives of the HOME Program?***

- 1) To expand the supply of decent, safe, sanitary and affordable housing,
- 2) To strengthen the abilities of state and local governments to provide housing; and
- 3) To expand the capacity of nonprofit community-based housing development organizations to develop and manage decent, safe, sanitary, and affordable housing.

#### ***How are funds allocated?***

Funds are allocated annually to states and local governments on a needs-based formula. This formula includes the number of low and very-low income families, the number of homeless individuals, local housing conditions, and local economic conditions. Typically, 40% of the funds are allocated to the state unit of government and 60% to local participating jurisdictions (PJs), generally, the larger cities. In order to receive funds, states and localities must generate a Consolidated Plan — a planning tool that documents community and housing statistics and sets community development goals, as part of a comprehensive strategy.

#### ***Who may apply?***

Eligible applicants are:

- Nonprofit organizations
- Units of general local government
- For-profit entities
- Public housing authorities
- State certified Community Housing Development Organizations (CHDOs)

At a minimum, 15% of the total HOME allocations must go to CHDOs.

#### ***What are eligible activities for HOME?***

There are four program categories for which funds are available. These are:

- Owner-occupied housing assistance
- First-time homebuyer assistance
- Tenant-based rental assistance
- Rental project assistance

Housing developed with HOME funds must serve households who are low-income, defined as 80% or less of median income for the area, as determined by HUD, with adjustments for family size. Each state or participating jurisdiction will further establish priorities for funding, which may include deeper levels of affordability. Moreover, many states and local jurisdictions consider HOME funds as a tool to leverage other funding and give priority to applications for funding that are combining HOME funds with other financing programs, such as the Low Income Housing Tax Credit program.

***How to apply.***

HOME funds are made available on a competitive basis, with the application cycle determined by the governmental unit administering the funds. Application deadlines and requirements can be obtained from the state or the participating jurisdiction.

**Community Development Block Grant (CDBG)**

***What is the CDBG Program?***

Enacted by the Housing & Community Development Act of 1974, the Community Development Block Grant (CDBG) Program provides a flexible source of annual grant funds for local governments to address their own particular development priorities. The impact of CDBG-funded projects can be seen in the housing stock, business environment, and the streets and public facilities of communities throughout the nation.

***What are the objectives of the CDBG Program?***

- 1) To revitalize neighborhoods
- 2) To expand affordable and economic opportunities
- 3) To improve community facilities and services

***How are funds allocated?***

Each year, the U.S. Department of Housing and Urban Development allocates CDBG funds to states and local governments according to relative need based on the higher of two formulas. The first formula considers the presence of overcrowded housing in the locality, its population, and poverty rate. The second uses housing age, population lag, and poverty rate to determine the allocation amount. HUD distributes approximately 70% of CDBG funds directly to about 1,000 of the largest local governments every year through the CDBG Entitlement Communities Program. The remaining funds are provided to the states, which then allocate the funds among localities that do not qualify as entitlement communities. In order to receive CDBG allocations, states and localities must generate a Consolidated Plan — a planning tool that documents community and housing statistics and sets community development goals, as part of a comprehensive strategy.

***Who may apply?***

Recipients of CDBG entitlement funds include local governments with 50,000 or more residents, other local governments designated as central cities of metropolitan areas, and urban counties with populations of at least 200,000. Local governments may administer the entire grant themselves or pass some or all of the funds to private or public nonprofit organizations as well as for-profit entities. State CDBG funds are awarded exclusively to municipalities with fewer than 50,000 residents and non-urban counties so that they may carry out community

development activities. Again, local municipalities may pass on these funds to outside organizations to carry out the community development priorities of the locality.

### ***What are eligible activities for CDBG?***

CDBG funds support a wide range of activities, provided the projects benefit low- and moderate-income families, prevent or eliminate slums and blight, or meet other urgent community development needs. If grantees (states or entitlement communities) choose to distribute funds, they establish priorities for funding (generally stated in the Consolidated Plan), which may include activities that assist in the development of affordable housing. Priorities are, however, limited by the activities eligible under the national program, including the following:

- Acquiring real property for program purposes
- Reconstructing or rehabilitating housing and other property
- Building public facilities and improvements
- Helping people prepare for and obtain employment through education and job training
- Assisting for-profit businesses for special economic development activities
- Providing public services for youths, seniors, or the disabled
- Carrying out crime reduction initiatives
- Assisting homebuyers
- Enforcing local building codes to reverse housing deterioration and blight

### ***How can CDBG funds be used as gap funding?***

CDBG funds may supplement other funding for affordable housing projects to pay for a variety of costs including land acquisition, construction costs, development costs, and relocation costs.

### ***How to apply.***

CDBG funds are made available on a competitive basis, with the application cycle determined by the governmental unit that administers the funds. Application deadlines and requirements can be obtained from the state or the entitlement community.

## **Community Housing Development Organizations (CHDOs)**

### ***What is a CHDO?***

A CHDO is a nonprofit, community-based organization that has been through a certification process at the state level. To qualify as a CHDO, an organization must meet, at a minimum, the following tests:

- Be organized under state or local laws and have IRS tax exempt status
- Have at least one-third of its governing board as low-income residents or elected representatives of such residents
- Maintain a formal process for low-income residents and program beneficiaries to advise the organization on relevant decisions

A CHDO cannot be a public body nor can it be controlled by, or under the direction of, individuals or entities seeking to derive profit or gain from the organization.

### ***What is a CHDO's Legal Status?***

A CHDO must meet the following criteria with regard to its legal status:

- A CHDO must be organized under state/local law.
- The provision of affordable housing must be among the purposes of the organization.
- No part of the CHDO's earnings may benefit any members, founders, contributors, or individuals.
- A CHDO should have a clearly defined geographic service area (nonprofits serving special populations must also define the geographic boundaries of their service area in order to qualify as a CHDO).
- A CHDO must have received a tax-exempt ruling from the IRS under Section 501(c) of the IRC of 1986.

### ***What is a CHDO's Organizational Structure?***

A CHDO is intended to respond to a particular community's needs, and the structure of its board of directors is considered the main indicator of community control. According to CHDO requirements, a minimum of one-third of the board of directors must consist of representatives of the low-income community, a requirement which may be met with one of three types of representatives:

- **Residents of low-income neighborhoods in the community.** A low-income community is defined as one in which 50% of the households have incomes at or below 80% of the area median income. Residents of low-income neighborhoods that serve on CHDO boards **do not** have to be low-income themselves.
- **Low-income residents in the community.** A community can be defined as a neighborhood or neighborhoods, a city, county, or metropolitan area. Low-income residents of low-income neighborhoods in the community **do not** need to submit proof of their income. However, if low-income residents of the community who do not live in low-income neighborhoods want to serve on the board, the CHDO must obtain certification from the resident that he or she is low-income.
- **Elected representatives of low-income neighborhood organizations.** A low-income organization is an organization composed primarily of residents of a low-income neighborhood, and whose purpose is to serve the interests of the neighborhood residents. This includes block groups, town watch organizations, civic associations, church groups.

Input from the low-income neighborhood is not met solely by having low-income representation on the board. The CHDO must also provide a formal process for low-income beneficiaries to advise the CHDO on the development and management of affordable housing. The process must be described **in writing**, and must be included in the organization's by-laws or a board resolution.



## **Division of Roles & Responsibilities between the General Partner & the Project Developer**

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**Owner.** The actual owner of the property being developed is the single-asset Limited Partnership, which consists of one or more general partners and one or more limited partners. Although you will file your limited partnership in simple format, once an equity partner has been identified and a partnership agreement is executed, the equity partner will fill the role of the limited partner. Generally, this limited partner owns 99.9% of the partnership, but does not have ultimate control of the partnership. This majority interest relates only to the distribution of the tax credits and bears no relation to other distributions such as cash flow and residual value, which are negotiated as part of the partnership agreement. The owner must be an accrual based tax payer.

**General Partner.** You can have one or more General Partners. Ultimate control of decision making rests with the General Partner(s), even though their percentage ownership is quite small. If there is more than one General Partner, one should be named the Managing General Partner. The General Partner accepts the responsibility for the project over the term of ownership and/or compliance, and has the authority to execute contracts and documents on behalf of the Limited Partnership. Compensation to the General Partner is made in recognition of early participation on non-eligible basis items, risks and guarantees, and later for asset management of the property (not to be confused with property management). Examples of activities relating to noneligible basis items include site identification, zoning, syndication activities, procurement of permanent financing, etc. The General Partner must be an accrual-based tax payer.

**Developer.** The Developer is the party responsible for development of the property. The Developer can be assisted by consultants, but the entire compensation to the consultants, Developer, and any co-developers cannot exceed the limits on development fees established by the State. Generally, these limits will range from 10 - 15% of eligible basis. In order for the developer fee to be included in eligible basis, the Developer must only receive compensation for activities related to eligible basis items, including development, construction, construction financing, etc. The developer may be affiliated with the General Partner. Because of carryover requirements, the Developer must be a cash-based taxpayer. Otherwise, the Developer will be forced to pay income taxes on the developer's fee that has been accrued by the partnership, but not actually paid.

### **Responsibilities of General Partner**

- ❖ Site identification, negotiations, zoning
- ❖ Activities related to off-site costs
- ❖ Identification of investors, negotiation with investors, review/negotiation of partnership agreement, and due diligence activities required by investor.
- ❖ Identification of permanent financing and negotiation of terms, prepare and file application, and undertake due diligence activities required by lender.
- ❖ Provide guarantees of construction costs and overruns, operating deficits for five years, delivery of tax credits, and such other guarantees as required by the investors and lenders.
- ❖ Management of the Asset in accordance with the partnership agreement, including providing reports as required by the partnership agreement and ensuring that tax returns are filed correctly and timely.

### **Compensation**

The compensation for the General Partner is going to take place following the placement of the project in service. The General Partner will receive a nominal amount of tax credits, but will receive compensation through an asset management fee, participation in cash flow distribution, and participation in residuals as a result of a sale or refinancing.

### **Responsibilities of Developer**

- ❖ Basic development activities and oversight – selecting architect, engineers, contractor, management agent, attorneys, accountants, consultants and other professionals; overseeing their work; negotiating fees; monitoring contracts; supervising work; ensuring compliance with timetables and program guidelines.
- ❖ Preparing financial proformas and determining budgets and feasibility.
- ❖ Identifying construction financing and negotiating terms. Applying for construction financing and undertaking due diligence activities with lender.
- ❖ Monitoring construction, preparing construction draws on behalf of the limited partnership, preparing disbursement instructions for the General Partner.
- ❖ Hiring management. Overseeing initial rent-up activities, ensuring that management has direction on the tenant profile and characteristics as agreed to in the initial application and Land Use Restriction Agreement, and liaison with investors and lenders.
- ❖ Identifying Service Providers, negotiating contracts, oversight of initial implementation.
- ❖ The Developer is frequently asked by investors and lenders to provide personal and corporate guarantees. Generally, if there is an identity of interest between the Developer and the General Partner, all principals will be required to give personal guarantees.

### **Compensation**

Compensation may be up to 15% of eligible basis. Actual fees for services will be outlined in a development agreement between the Limited Partnership and the Developer. Disbursement of the Developer's fee as part of the equity and construction loan proceeds is negotiated as part of the partnership agreement; however, IRS has rules relating to how much can be accrued for purposes of carryover. Any amount of the developer fee that cannot be disbursed as part of the initial project costs can be carried forward as a deferred note and paid as a priority distribution from cash flow. In order to be categorized as part of eligible basis, this amount must be able to be paid to the developer in the first 10 years of operation.