Government Programs

Credits and Incentives Continue to Fuel Development

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Speaker Bio

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Howard Gordon’s practice is focused on commercial and multi-family real estate, commercial leases, ground leases, land use planning and permits and pass-through entities. Mr. Gordon’s experience includes representing owners and developers in the acquisition of land, development, leasing and financing of numerous shopping centers and multi-family housing projects, as well as hotels and development of a traditional neighborhood. He also has represented borrowers in the closing of conventional, FHA-insured, conduit and specialty loans secured by commercial and multi-family properties. Mr. Gordon has represented developers of multi-family housing properties which received Low Income Housing Tax Credits or Section 8 Housing Assistance Payment Contracts and were financed by either loans from the Virginia Housing Development Authority, loans insured by FHA or local housing authority bonds. He has also represented developers of hotels which have used New Markets Tax Credits to reduce the equity required for development.

Mr. Gordon is a Fellow of the American College of Real Estate Lawyers, The American Bar Foundation and the Virginia Law Foundation. He is listed in *The Best Lawyers of America* and in the Top 100 Lawyers by *Virginia’s Super Lawyers*.

Historic Tax Credits and Low Income Housing Tax Credits

HTC Program Overview

What: Two-tier investment tax credit program established in 1978 to encourage the rehabilitation of historic buildings without losing architectural significance. Additional modifications made to encourage temporary reinvestment after natural disasters.

- Certified historic structures = 20% ITC
- Pre-1936 nonresidential buildings = 10% ITC

How: IRS administers income tax aspects of the program

National Park Service (NPS) and State Historic Preservation Officers (SHPOs) jointly administer "certification" process

Investors make cash investments in project level fee owner entity (or master tenant entity) in exchange for income tax credits, tax losses, and cash flow

Developers use tax equity proceeds to fill the gap between project debt and equity financing

Benefits: Tax Credit Investors generally obtain federal income tax credit as a percentage of Qualified Rehabilitation Expenditures (QREs) incurred in the period the project is placed in service.

Progress Expenditure Election available for projects with "normal" construction period of 2 years or more allowing credits to be claimed as QREs are incurred.

$1 of project QRE yields approximately $0.20 of tax equity at closing

Historic Tax Credit

Amount of Credit:

- 20% of QRE – capital costs incurred in the rehabilitation of a Certified Historic Structure which exceed the taxpayer's basis in the building. Costs incurred in 24 months or 60 months for a phased rehabilitation.

Timing of Credit:

- Entire Credit can be taken in the year the project is placed in service.

Specific Restrictions:

- The building must be either listed in the National Register of the National Park Service or located in a registered historic district and certified as being of historical significance (Part I Certification). The work must qualify as a Certified Rehabilitation by approval of the Historic Preservation Certification Application (Part II Certification). Upon completion and inspection, the taxpayer must receive the Part III Certification and the Credit can be taken.

Historic Tax Credit, cont.

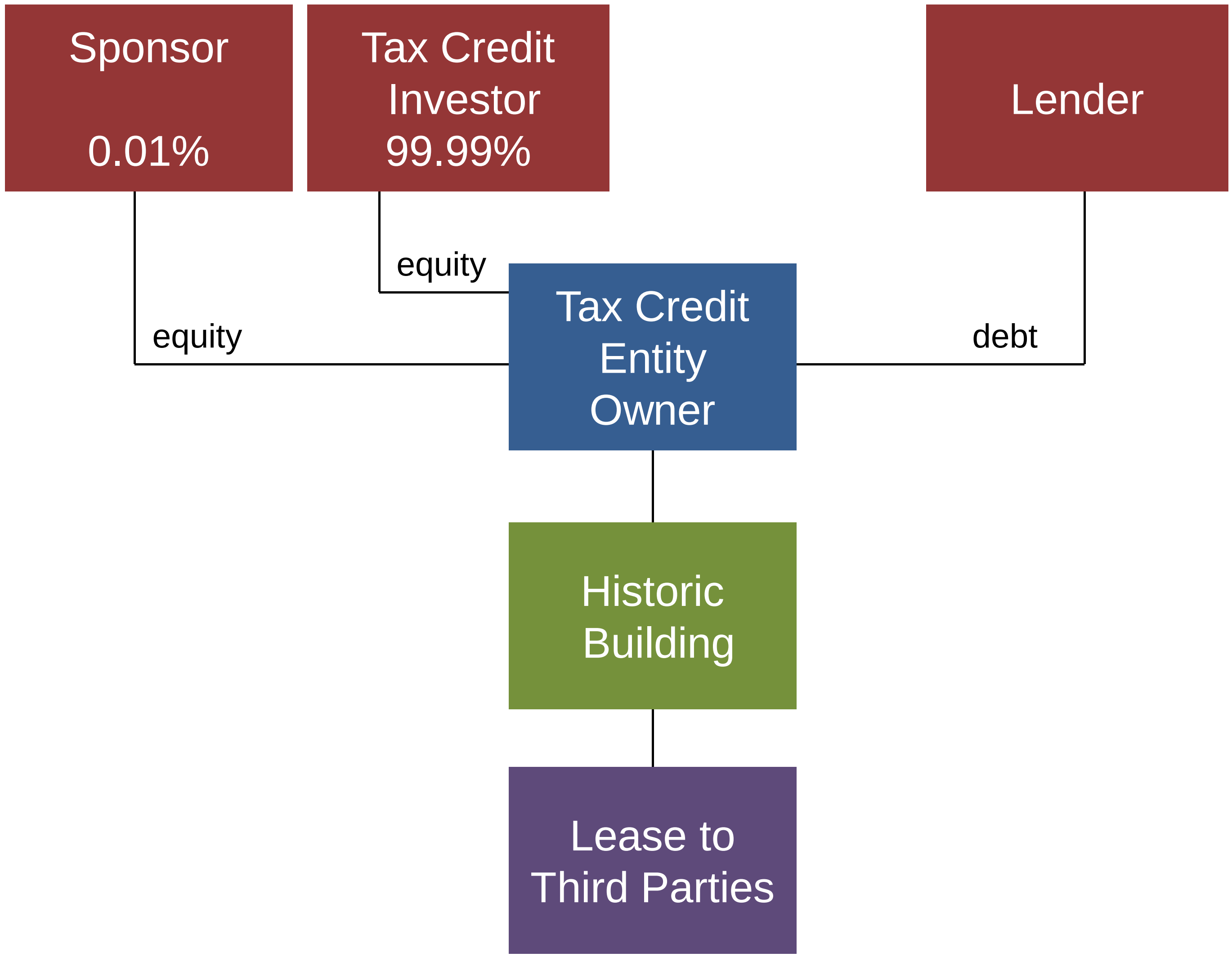
Recapture:

- Ownership entity must retain ownership for 5 years. If the Credit is recaptured, it is 100% in the first year and declines by 20% for each succeeding year.

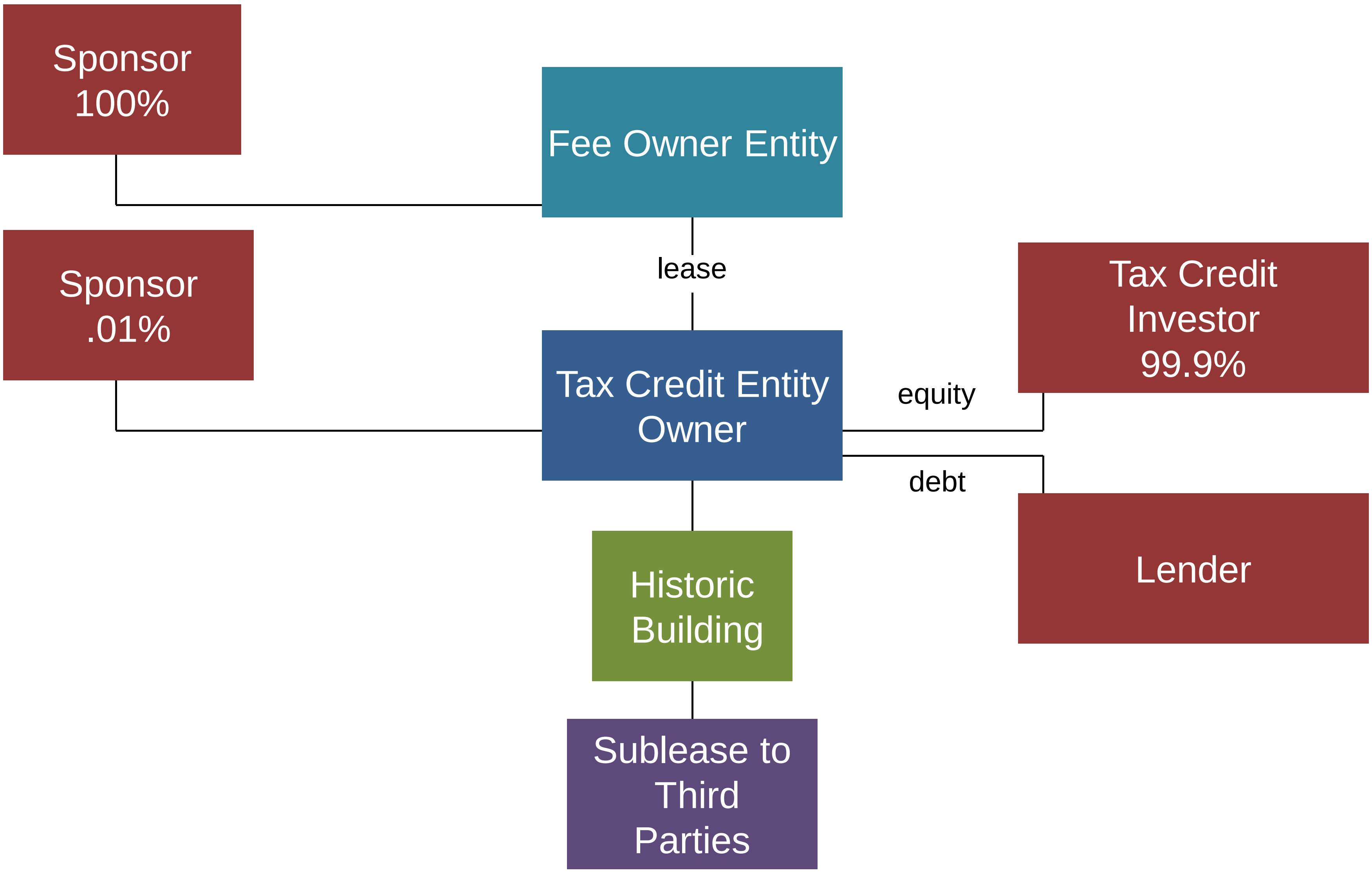
Usual Structure:

- Limited Partnership or Limited Liability Company with Investor receiving 99.99% of profits, losses and credits and sponsor receiving 0.01%. Sponsor can receive a development fee which is a part of the QRE. At the end of the Recapture Period, the sponsor will generally buy out the interest of the Investor for a minimal sum pursuant to a put or call negotiated at the time the investment is made.

Direct Historic Tax Credit Structure



Indirect Historic Tax Credit Structure



Low Income Housing Tax Credits Program Overview

What:

- Federal Tax Credit Programs established as part of the Tax Reform Act of 1986 by adding Section 42 of the code to encourage the development of multi-family housing for low to moderate income persons and families.
  - New Construction = 9% / year LIHTC
  - Rehabilitation = 4% / year LIHTC

How:

- Administered by Department of Treasury. Each state receives an allocation of LIHTC based on population. Credits are then reallocated to specific projects designated by the state agency (Housing Finance Agency).
- <u>Investors</u> make equity investment in project owner in installments in exchange for a 99+% of profits, losses and credits and a substantially smaller interest in cash flow and distributions.
- <u>Developers</u> use tax credit proceeds as equity in the project allowing for less debt financing to be required while keeping rents affordable for qualified tenants.

Low Income Housing Tax Credits Program Overview

Benefits

- Tax Credit Investors receive the credits over the first 10 years of the compliance period equaling approximately 90% of qualified basis in acquisition/new construction and 40% of qualified basis in rehabilitation projects.
- The stock of housing serving low to moderate income tenants is substantially increased as the result of the Credits.
- An affiliate of Developer receives a fee for guarantying project completion without cost overruns, etc. and this fee is includable in the project's basis.
- $1 of tax credit yields approximately $0.90 or $0.40 of tax savings over a 10 year period.

Low Income Housing Tax Credit

Amount of Credit:

- Acquisition/New Construction – 9% of Total Development Cost per annum for 10 years
- Rehabilitation – 4% of rehabilitation costs per annum for 10 years (4% credit is also used where developer finances its acquisition, construction or rehabilitation with tax exempt bonds)

Timing of Credit:

- First year of Credit commences when building or project is placed in service.

Specific Restrictions

- Income of tenants in property or units which qualify for the Credits is limited to either 40% of Units at 60% of area median or 20% of Units at 50% of area median, but Credits can be obtained for entire property.

Low Income Housing Tax Credit, cont.

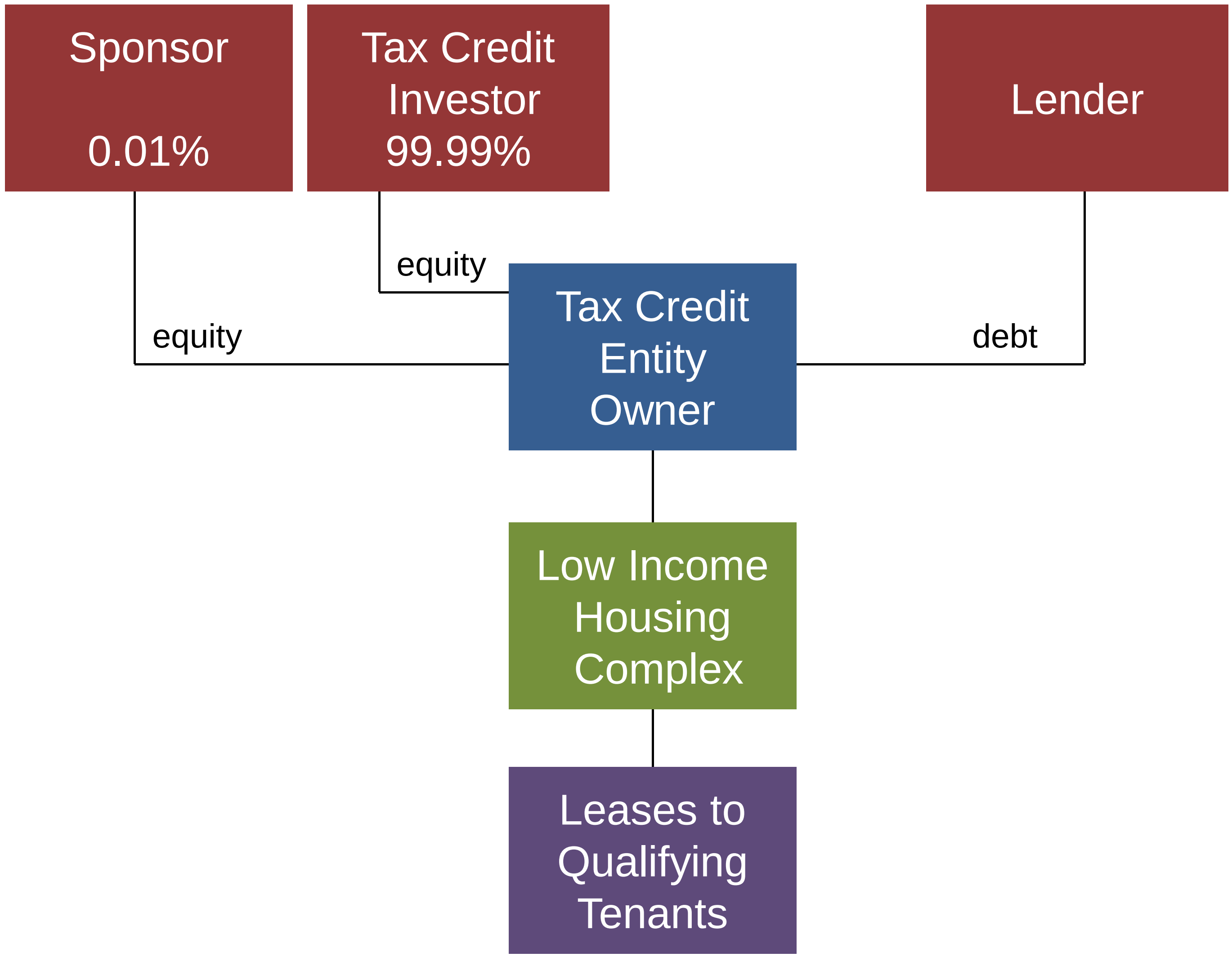
Recapture:

- The Tax Credit Compliance Period is 15 years, while the Credits are taken over only 10 years. A failure to comply with these requirements results in a recapture of 100% in year 11 and reduces 20% per year thereafter.

Usual Structure:

- Limited Partnership or Limited Liability Company with Investor receiving 99.99% of profits, losses and credits and sponsor receiving 0.01%.
- Cash flow from operations and proceeds resulting from a sale or refinancing generally provide for the sponsor to receive a minimum of 50%, after all fees are paid.
- Sponsor receives a substantial developer fee which is included in basis for the amount of available credits and for which the sponsor assumes certain risks.
- Recent structures are also addressing the exit strategy for the investor and what it may be entitled to receive to withdraw from the entity at the end of the 15-year Compliance Period.

Low Income Housing Tax Credit Structure



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