

# THE LOW INCOME HOUSING TAX CREDIT 101:

## *An Introduction*

# Who We Are

- Strategic Tax Credit Investments (STCI), is an investment advisory, brokerage and consulting firm focused on affordable housing
- Established in 2010 by David Robbins, a LIHTC industry veteran of over 20 years
- STCI works with syndicators on strategic positioning, raising investor equity and product development
- STCI works with clients nationally through offices in Massachusetts and Oregon

# Disclosure

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# The Public Housing Stereotype





# *This is Affordable Housing:*

## Woodfield Village II in Howard, WI



# *This is Affordable Housing:*

## Hacienda Heights in Kerman, CA





# *This is Affordable Housing:*

## Marcis Pointe in Jacksonville, FL





# LIHTC History

The Low Income Housing Tax Credit



# LIHTC History

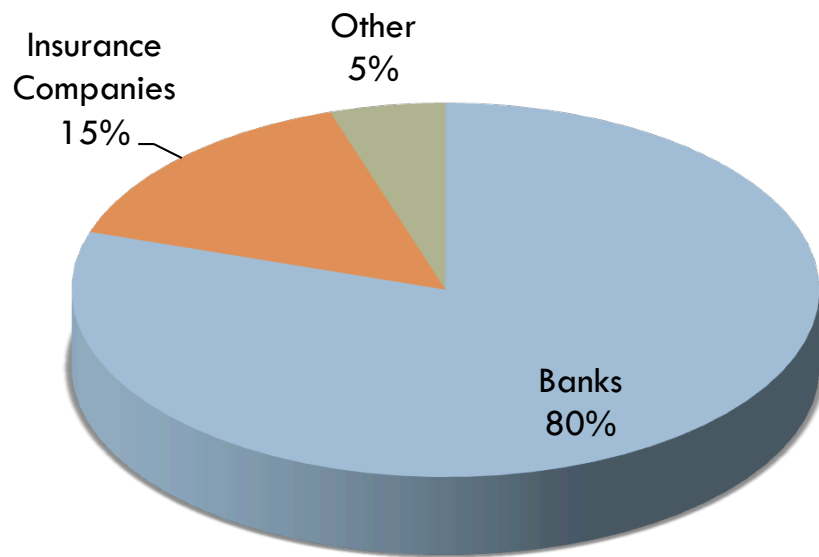
- Most successful housing program in U.S. history
  - ▣ More than 2.5 million housing units created
  - ▣ Part of 1986 tax act, made permanent in 1993
  - ▣ Long history of bipartisan support
  - ▣ Expanded and improved after 2008 financial crisis
- Estimated \$11+ billion market in 2014
  - ▣ Predominant investors are banks and insurance companies

# LIHTC Benefits

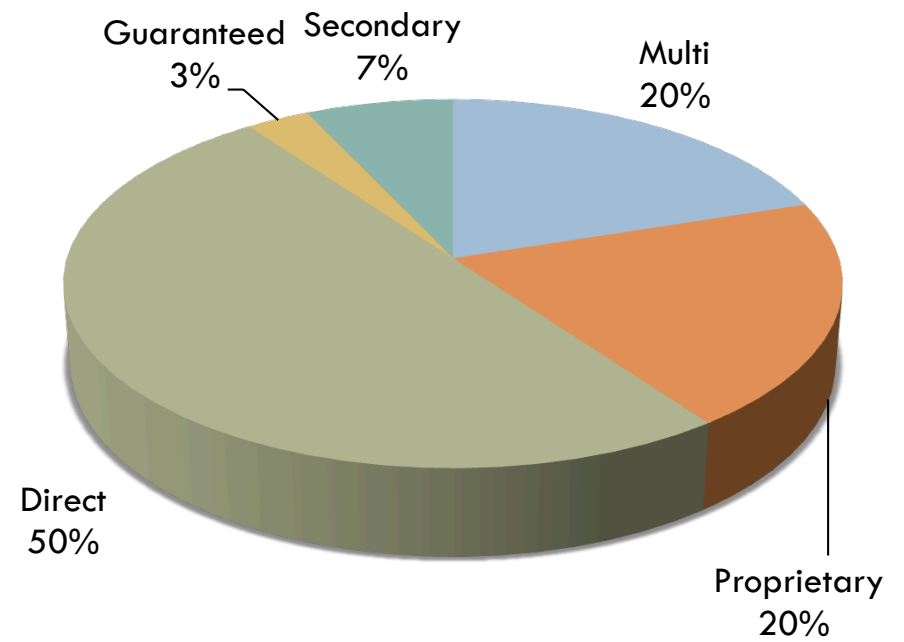
- The Affordable Housing Tax Credit (Section 42 of the tax code), is based on a private-public partnership to generate investment in the creation of affordable rental housing
- Tax credits provide a dollar for dollar reduction in federal income tax liability
- Tax losses flow through to equity investor
- Socially responsible investment. Satisfies Community Reinvestment Act (CRA) requirements under the investment test.

# Projected 2014 LIHTC Market

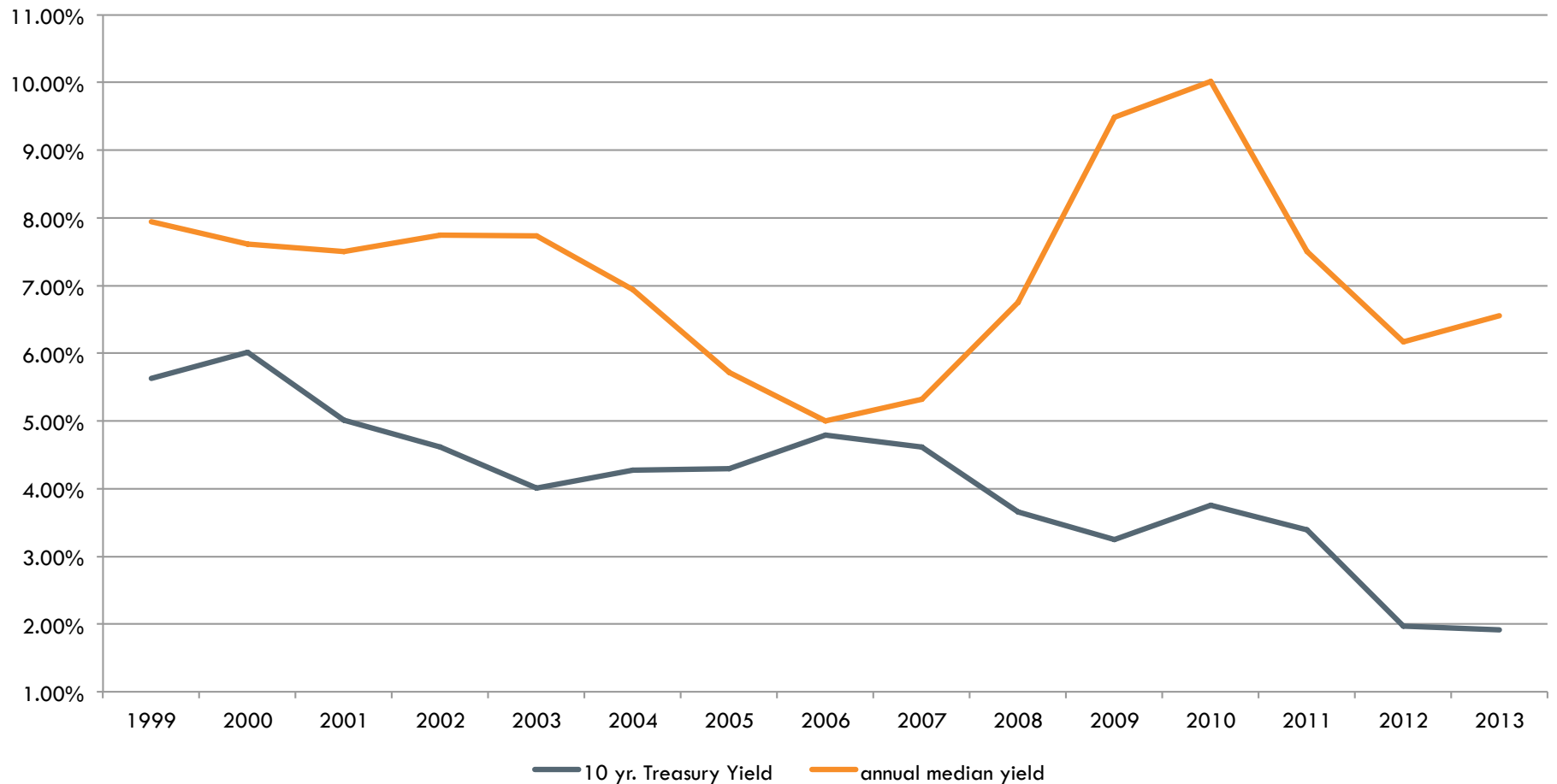
## LIHTC Investor Breakdown



## Investor Type



# Fund Yields vs. 10-Year Treasury by Year





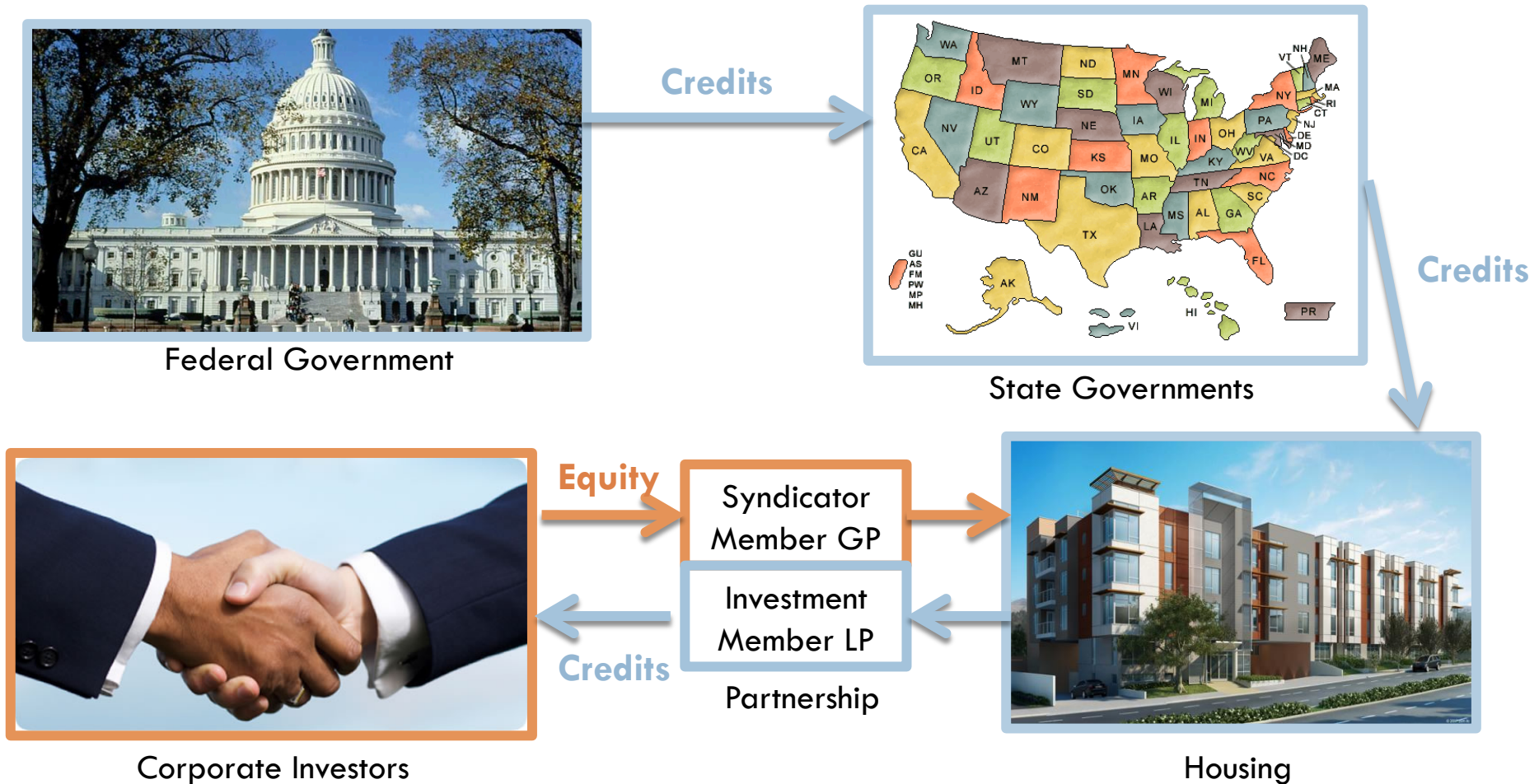
# LIHTC Synopsis

- Each state receives a pool of credits based on population: \$2.30 per capita (minimum of \$2.635MM per state)
- Each state awards the credits to housing developers through a competitive application process (9% credits only)
- There are two forms of credit: 9% and 4% credits. The 4% credits are awarded in conjunction with tax exempt state bond financing
- Credits are claimed evenly over a 10 year period, while the property must meet compliance guidelines for 15 years

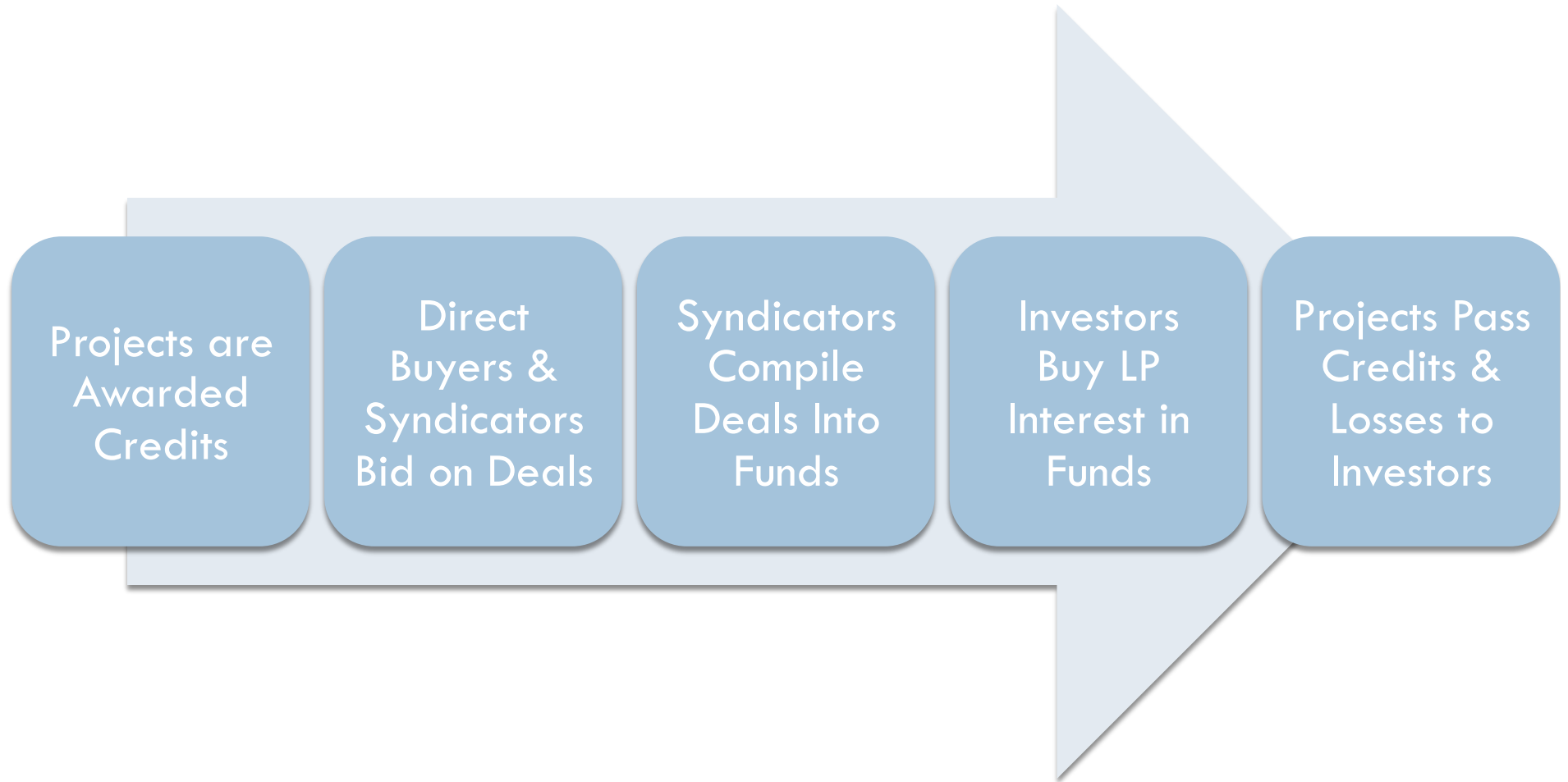
# LIHTC Synopsis

- Once the state allocates credits to the project, the developer must complete the project, certify its cost and lease units to qualified tenants within a set timeframe
- Equity is raised (and leverage reduced) by syndicating the credits to an investor or group of investors (limited partner). The investor receives the tax credit over a ten year period
- The private sector develops and manages the properties and takes the risk rather than the government
- Foreclosure or non-compliance with tax credit guidelines can result in the loss of credits
- Foreclosure is the primary risk, but the the foreclosure rate for the asset class has been less than 1% historically

# LIHTC Flow: Public/Private Partnership



# LIHTC Flow





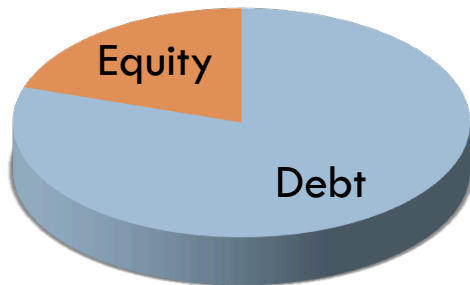
# LIHTC Structure



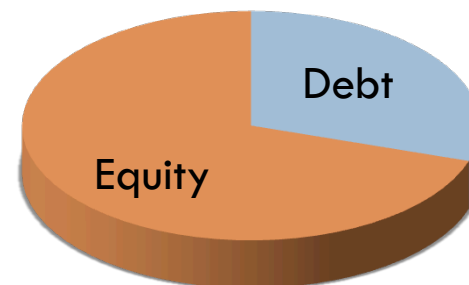
# LIHTC Structure

- Rents are restricted so they are affordable to low and moderate income households. How is this achieved?
  - ▣ Investor equity reduces the amount of debt necessary
  - ▣ With lower debt service, the project is able to charge lower rents, which allows housing for low income tenants at affordable rents

**Market Rate:**



**Affordable Housing:**



# Property Level (Lower Tier) Tax Credit Equity Calculation

Total Development & Costs	\$20,000,000
(Land)	(1,000,000)
(Ineligible Costs)	(750,000)
<b>Total Eligible Basis</b>	<b>18,250,000</b>
% of Units LIHTC	100.00%
Total Qualified Basis	18,250,000
Credit Rate	9.00%
Annual Tax Credits	1,642,500
Years of Credits	10
Total Credits	16,425,000
Price Per Credit	\$0.96
<b>Total Equity</b>	<b>\$15,768,000</b>

# Property Level Sources & Uses

Sources	
Total Investor Equity	\$15,768,000
Hard Debt	6,750,000
Soft Debt	1,000,000
Deferred Development Fees	300,000
Total Sources	\$23,818,000
Uses	
Land	\$1,000,000
Hard Costs	14,500,000
Soft Costs	5,700,000
Developer Fee	1,950,000
Reserves	668,000
Total Uses	\$23,818,000



# Investor Incentives

## ▣ Financial Gain

- Tax credits reduce corporate tax liability
- Additional tax losses from depreciation, interest and operations
- Some potential for proceeds from cash flow, refinancing and residuals

## ▣ Socially responsible

- Fulfilling Community Reinvestment Act (CRA) requirements
- Creation of affordable housing for low and moderate income Americans

# LIHTC General Partnership Structure

	Developer	Investor
<b>Partner Level</b>	General or 'GP'	Limited or 'LP'
<b>Management of Project</b>	Yes	No
<b>Partnership Control</b>	Primary	Secondary – Veto Rights
<b>Share of LIHTC</b>	0.0001	0.9999
<b>Share of Capital Contribution</b>	0.01%	99.99%
<b>Share of Cash Flow / Residual Value</b>	90.00%	10.00%

# Sample Effect on Effective Tax Rate

Corporation X (No LIHTC Investment)	
2013 Profit	\$10,000,000
Tax Rate	35%
Tax Liability	\$3,500,000
<i>Annual Tax Credits Applied</i>	<u>-\$0</u>
<i>Net Tax Liability</i>	\$3,500,000
Net Profit After Taxes	\$6,500,000
<b>Effective Tax Rate</b>	<b>35%</b>

Corporation X ( <i>With \$10MM LIHTC Investment</i> )	
2013 Profit	\$10,000,000
Tax Rate	35%
Tax Liability	\$3,500,000
<i>Annual Tax Credits Applied</i>	<u>-\$1,000,000</u>
<i>Net Tax Liability</i>	\$2,500,000
Net Profit After Taxes	\$7,500,000
<b>Effective Tax Rate</b>	<b>25%</b>

# Sample Benefit Schedule

**Investor Quarterly IRR: 6.15%**

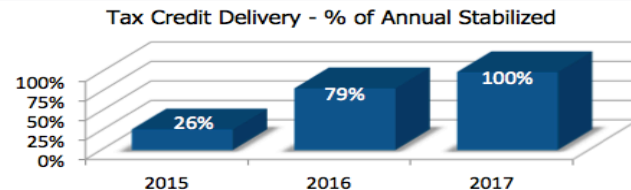
**Price Per Credit: \$1.067**

	A	B	C	D	E	F	G
				= C * (1-35%)	= B + D	= E - A	
Year Ending 31-Dec	Capital Contribution	Federal Tax Credits	Tax (Gains) / Losses	Tax Deductions	Total Tax Benefits	Total After-Tax Net Benefits	Cumulative After Tax Benefits
2015	\$ 169,965	\$ 24,883	\$ 37,647	\$ 13,176	\$ 38,059	\$ (131,906)	\$ (131,906)
2016	498,679	74,555	101,746	35,611	110,167	(388,513)	(520,418)
2017	300,892	94,124	93,458	32,710	126,834	(174,058)	(694,476)
2018	3,324	94,124	78,312	27,409	121,533	118,209	(576,267)
2019	3,324	94,124	71,373	24,981	119,104	115,780	(460,487)
2020	15,711	94,124	68,768	24,069	118,192	102,481	(358,006)
2021	847	94,124	59,894	20,963	115,087	114,240	(243,766)
2022	847	93,983	53,357	18,675	112,658	111,811	(131,955)
2023	847	92,700	50,938	17,828	110,529	109,682	(22,273)
2024	847	91,953	50,519	17,682	109,635	108,788	86,515
2025	847	69,306	52,223	18,278	87,584	86,737	173,252
2026	3,871	19,595	58,733	20,557	40,152	36,280	209,533
2027	-	-	48,403	16,941	16,941	16,941	226,474
2028	-	-	41,632	14,571	14,571	14,571	241,045
2029	-	-	83,470	29,214	29,214	29,214	270,260
2030	-	-	48,284	16,899	16,899	16,899	287,159
<b>Totals</b>	<b>\$ 1,000,000</b>	<b>\$ 937,594</b>	<b>\$ 998,757</b>	<b>\$ 349,565</b>	<b>\$ 1,287,159</b>	<b>\$ 287,159</b>	
<b>\$ 1,000,000 Total Commitment</b>							

Investor Quarterly Pre-Tax IRR: 9.46%  
Investor Tax Bracket: 35%

Credit Ratio 0.94  
Loss Ratio\* 1.00

*\*Excludes losses from Compliance Reversion*



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# LIHTC Accounting Change

Proportional Amortization Method

# Proportional Amortization Method

- In November of 2013, FASB approves changes to GAAP Accounting for LIHTC. At the option of the investor, LIHTC investments could now be recorded under the equity method or the new proportional amortization method.
- The key benefit from proportional amortization is for investors is the ability to reflect Pass-Through book losses below Net Income before taxes. (see below)

	Equity Method	Proportional Amortization Method
Company Income	\$50,000,000	\$50,000,000
Pass-Through book loss	(5,500,000)	-
<b>Net Income Before Tax</b>	<b>44,500,000</b>	<b>50,000,000</b>
Tax Expense, pre-credits (35%)	15,575,000	17,500,000
Tax Credits	(10,000,000)	(6,400,000)
Net Tax Expense (net of amortization)	5,575,000	11,100,000
<b>Net Income After Tax</b>	<b>38,925,000</b>	<b>38,900,000</b>

# Proportional Amortization Method

- The proportional amortization method requires the initial cost of the investment (inclusive of unconditional future capital commitments) to be amortized in proportion to the tax benefits received over the period that the investor expects to receive the tax credits and other tax benefits.
- The computation holds the initial investment balance constant each period. The amortization would be based on a percentage of total tax benefits received in a particular year (numerator) relative to the total tax benefits expected over the life of the investment (denominator). Any residual value is excluded from the amortization. (assumed that is zero)

# PAM Demonstration: Benefits Schedule

Investment Information		Composite Tax Rate	
Capital Investment:	10,000,000	Composite Tax Rate	35.00%

	A	B	C	D	E	F	G		(F-G)
			Historic	Net		Annual Tax Savings (Tax Credits Less Deductions at 35.00% Tax Rate)	Equity Prorated Proportionally with Tax Savings Stream		Amount Taken into Income PAM
Year	Capital Investment	Tax Credits	Tax Credits	Tax Credits	Tax Deductions		P.A.M \$\$	%	
2014	3,023,703	142,052	210,616	352,668	(114,410)	392,712	126,705	2.9%	266,007
2015	4,437,221	674,136	322,880	997,016	(682,522)	1,235,898	755,868	9.2%	480,030
2016	2,236,654	969,946	-	969,946	(784,264)	1,244,438	868,544	9.2%	375,894
2017	152,422	976,628	-	976,628	(669,518)	1,210,959	741,467	9.0%	469,492
2018	50,000	976,628	-	976,628	(619,051)	1,193,296	685,577	8.9%	507,719
2019	50,000	976,628	-	976,628	(635,589)	1,199,084	703,892	8.9%	495,193
2020	50,000	976,628	-	976,628	(671,257)	1,211,568	743,393	9.0%	468,175
2021	-	976,628	-	976,628	(546,276)	1,167,825	604,981	8.7%	562,844
2022	-	976,628	-	976,628	(535,852)	1,164,176	593,436	8.6%	570,740
2023	-	976,628	-	976,628	(532,205)	1,162,900	589,397	8.6%	573,502
2024	-	846,127	-	846,127	(540,647)	1,035,353	598,747	7.7%	436,606
2025	-	302,492	-	302,492	(681,691)	541,084	754,947	4.0%	(213,864)
2026	-	6,682	-	6,682	(523,892)	190,044	580,191	1.4%	(390,146)
2027	-	-	-	-	(478,549)	167,492	529,976	1.2%	(362,483)
2028	-	-	-	-	(475,342)	166,370	526,424	1.2%	(360,054)
2029	-	-	-	-	(538,578)	188,502	596,456	1.4%	(407,953)
	10,000,000	9,777,831	533,496	10,311,327	(9,029,644)	13,471,702	10,000,000	100%	3,471,702



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# LIHTC 101 Summary

# Summary

- The Federal government funds the program through tax credits
- State housing agencies award the credits to individual projects through highly competitive application process
- A syndicator typically creates a fund to channel investor equity to selected developments
- Developers receive capital for development
- Investors receive a 10 year tax credit, which provides financial gain and other incentives
- Quality rental housing is created for working Americans of low and moderate income
- Syndicators manage the fund, monitor and manage the assets, and report to investors over the life of the investment



# Other considerations

- Investment Term: Typically 17-18 year investment partnership including construction period, 15 year compliance period and disposition.
- Liquidity: relatively illiquid; however there is an active secondary market
- Lack of comparable alternative investments

# Additional LIHTC Resources

- [novoco.com](http://novoco.com)
- [ahic.org](http://ahic.org)
- [housingfinance.com](http://housingfinance.com)
- [taxcreditcoalition.org](http://taxcreditcoalition.org)
- [housingonline.com](http://housingonline.com)

# STCI Contact Information

**Dave Robbins**

50 Braintree Hill Office Park  
Suite 105  
Braintree, MA 02184

617.340.7040  
(office & mobile)

[drobbins@strategictci.com](mailto:d Robbins@strategictci.com)

**Brian Rajotte**

1722 NW Raleigh St.  
Suite 420  
Portland, OR 97209

503-575-9232  
(office & mobile)

[brian.rajotte@strategictci.com](mailto:brian.rajotte@strategictci.com)

[stci.com](http://stci.com)