An Analysis of 50% "Financed By" Test for Private Activity Bonds

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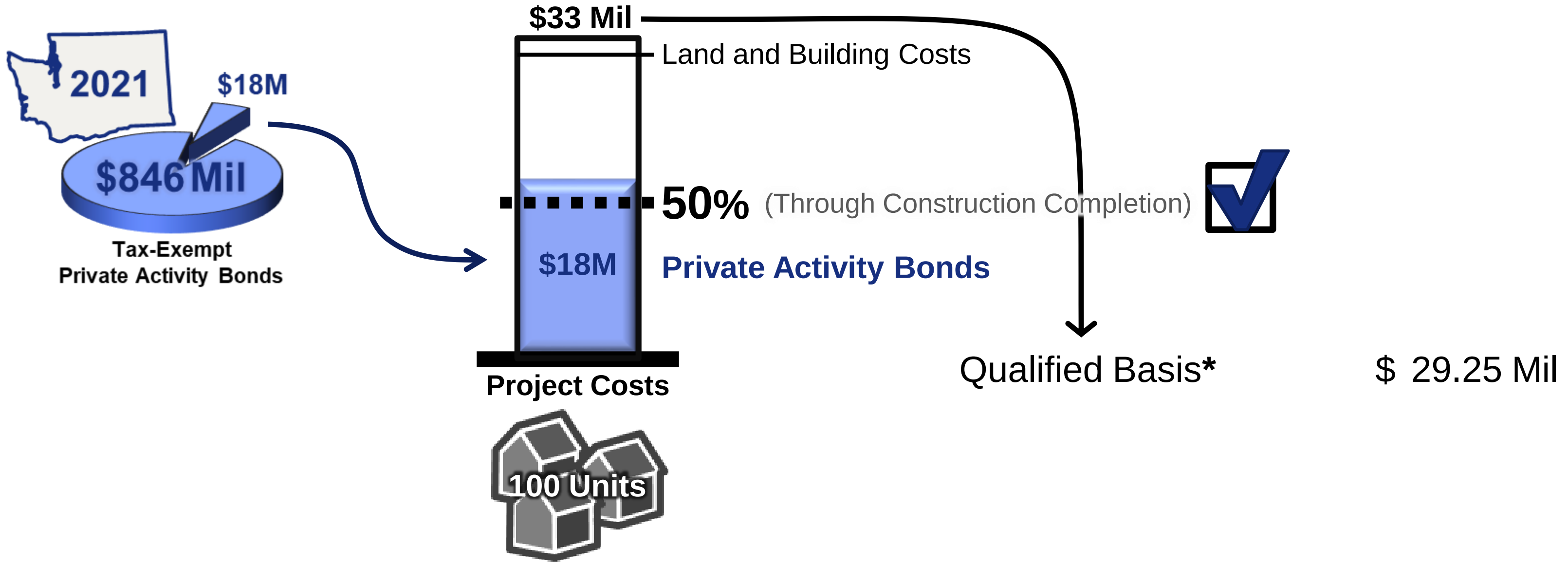
Disclaimer

Example Based on a Seattle Property



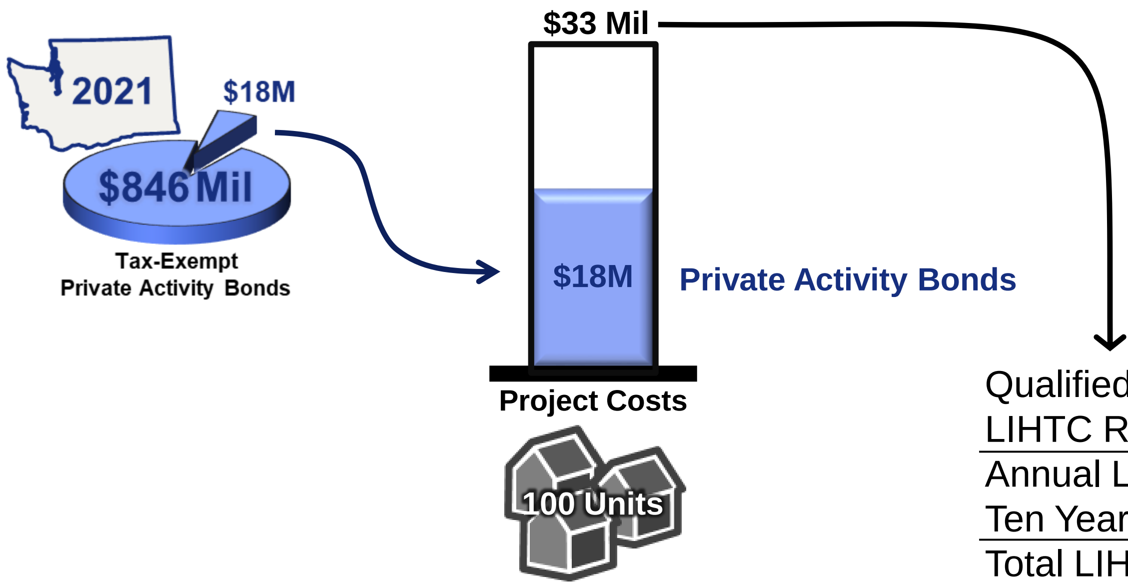
*Eligible fixed assets multiplied by portion of total units that are dedicated for low-income households

This example is based on a property in Seattle, Wash. Assume total project costs are $33 million and will finance 100 residential rental units.

According to Internal Revenue Code (IRC) Section 42(h)(4)(B), if 50% or more of land and building costs are financed by tax-exempt private activity bonds from a state's annual volume cap, that building can use all of its qualifying costs to generate low-income housing tax credits (LIHTCs).

A bond allocation of $18 million from Washington's $846 million 2021 private activity bond volume cap will easily finance land and building costs of a project in which total costs are $33 million.

Example Based on a Seattle Property



Qualified Basis*	$	29.25 Mil
LIHTC Rate	x	4%
Annual LIHTCs	$	1.17 Mil
Ten Years	x	10
Total LIHTCs	$	11.7 Mil
LIHTC Price per Credit	x	0.94
LIHTC Equity	**$**	**11 Mil**

*Eligible fixed assets multiplied by portion of total units that are dedicated for low-income households

As of 2021, the rate by which a building's qualified basis can be multiplied is 4%.

In our example, this property is generating LIHTCs of $11.7 million over 10 years.

Assuming investors are willing to contribute equity at a rate of $0.94 per dollar in credits, LIHTC equity would total $11 million to pair with the $18 million in bond proceeds.

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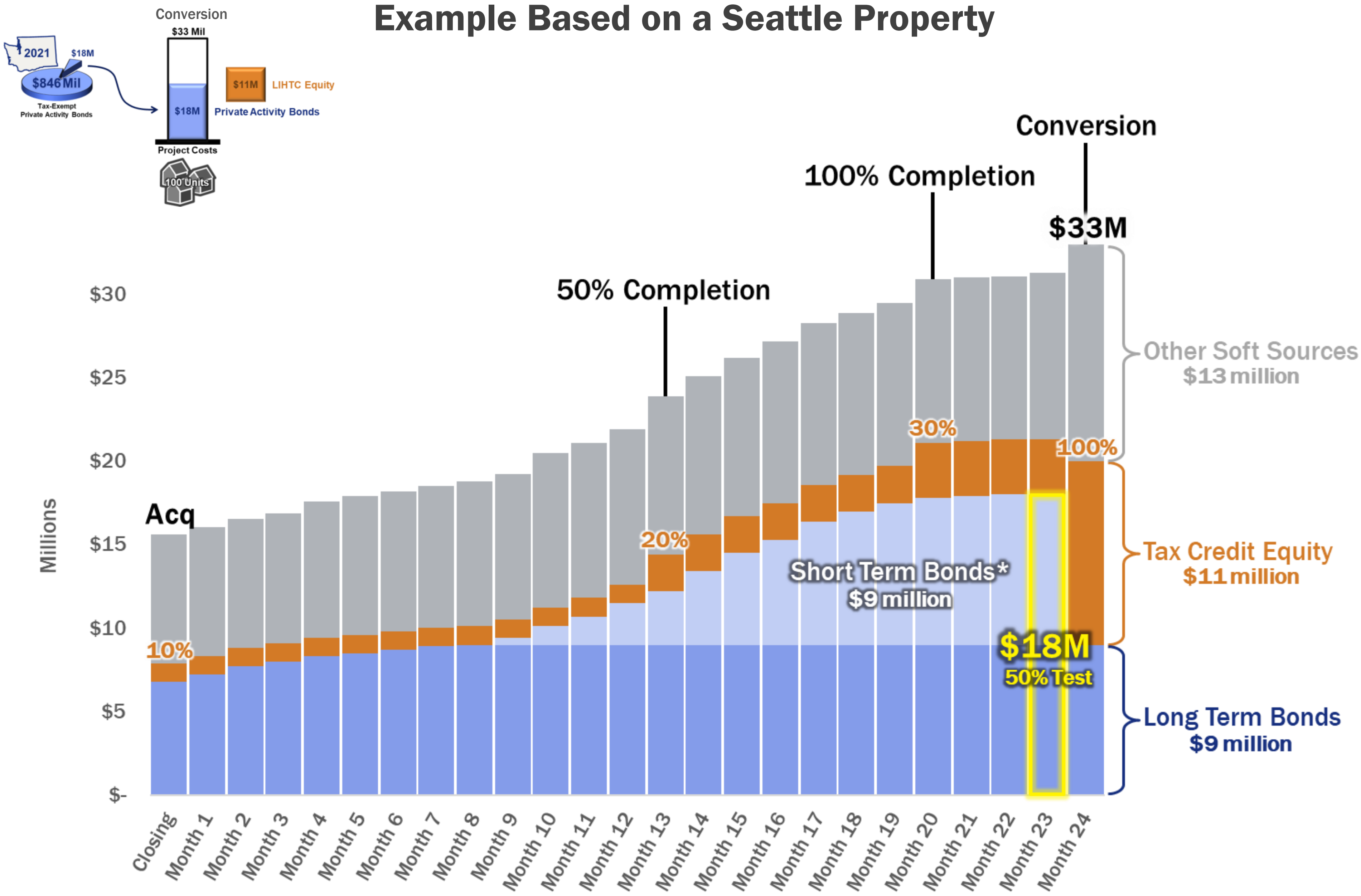


*Short term bonds secured by full $11 million in tax credit equity

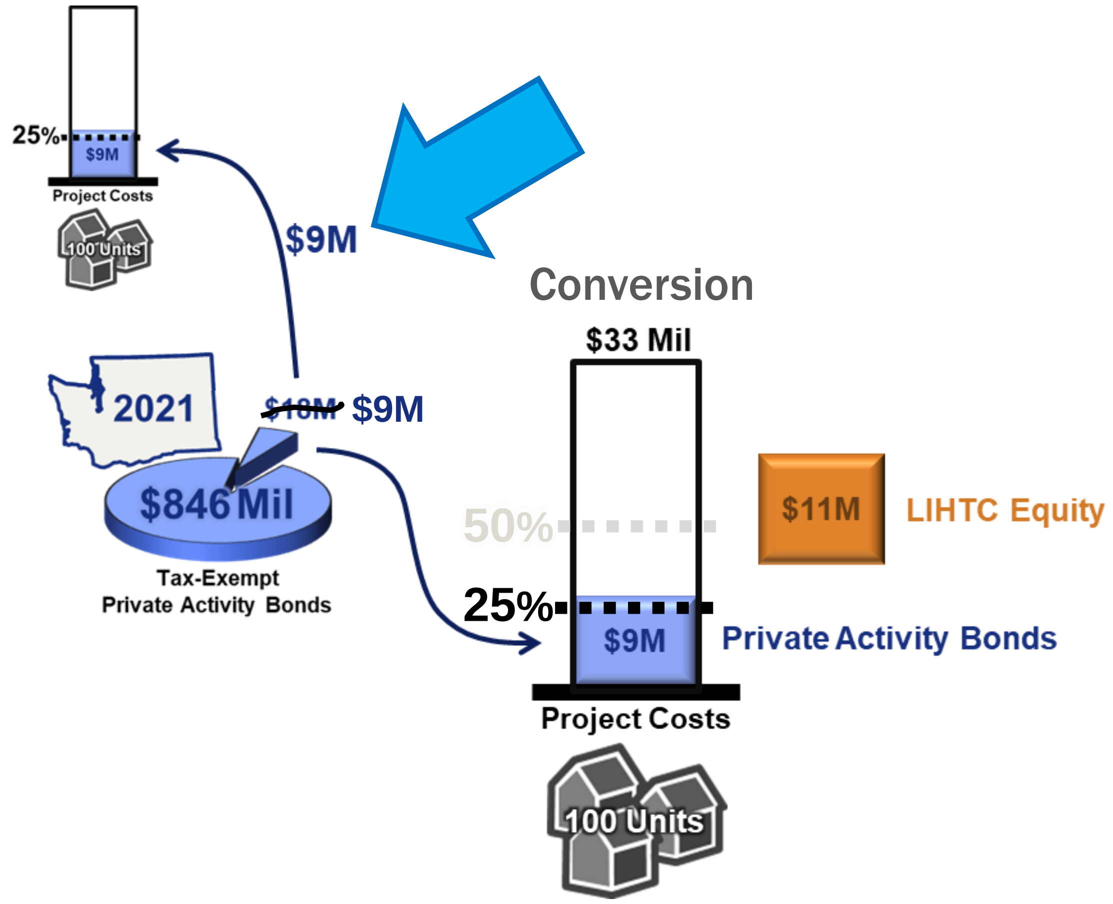
Common practice is for only a small amount of tax credit equity to be paid at the beginning of development. Our example is an acquisition/rehabilitation project in which acquisition costs are slightly greater than $15 million.

Only 10% of total equity is paid at closing. Another 10% is paid at 50% completion. Another 10% is paid at 100% completion. The remaining 70% is paid at conversion.

Of the total $18 million in bond proceeds, only half are long term bonds. The remaining $9 million are in the form of short-term bonds secured by the full $11 million in equity to be paid later.

Due to the availability of other soft financing sources (explained later) totaling $13 million, only $9 million in long-term bonds remain at conversion.

If “financed by” threshold is lowered to 25%…



In states with more soft financing sources available, lowering the “financed by” threshold from 50% to 25% could free up the $9 million—that was used in our example as short term bonds to be retired at conversion—to be used to finance other affordable housing units.

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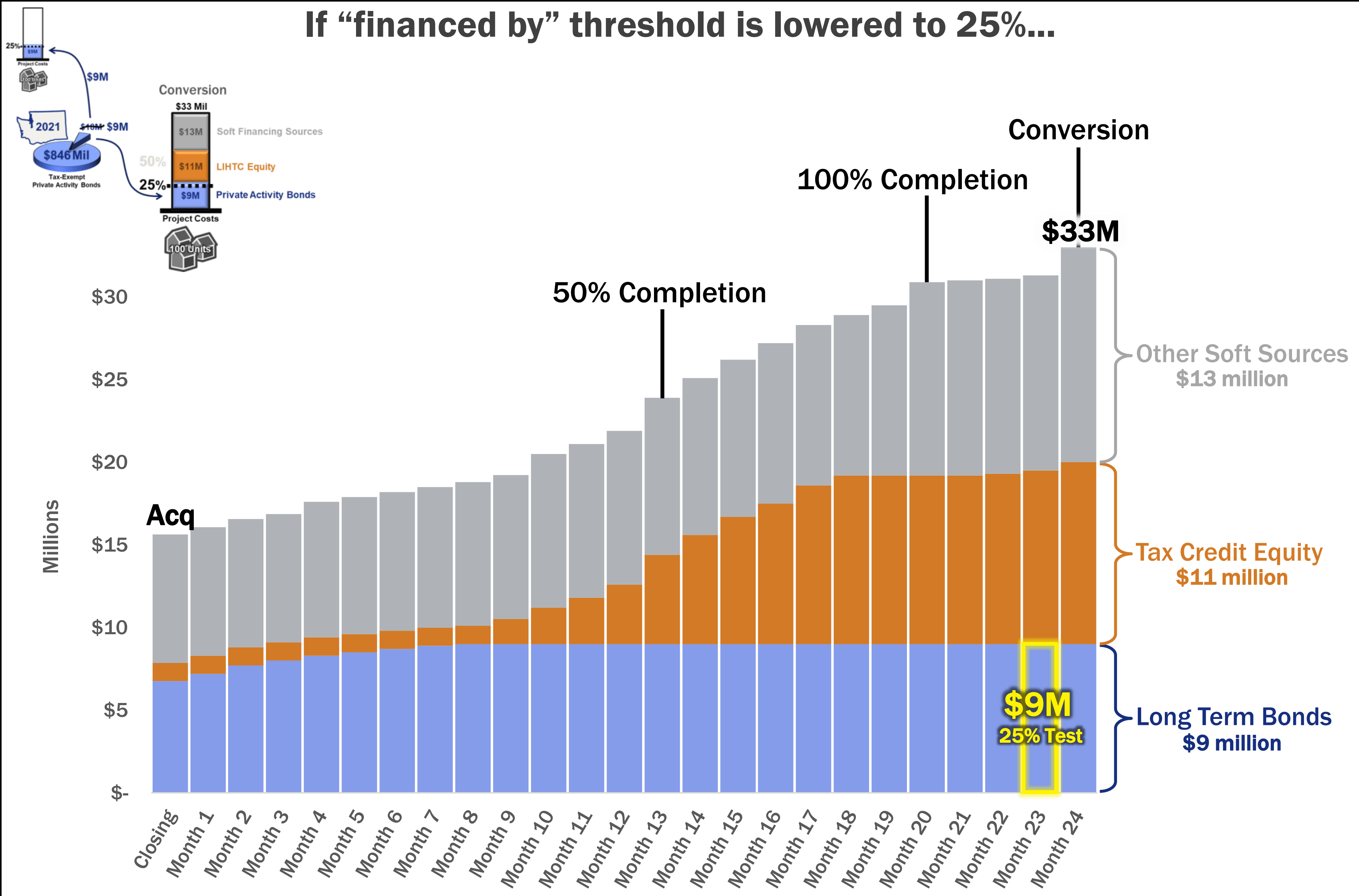
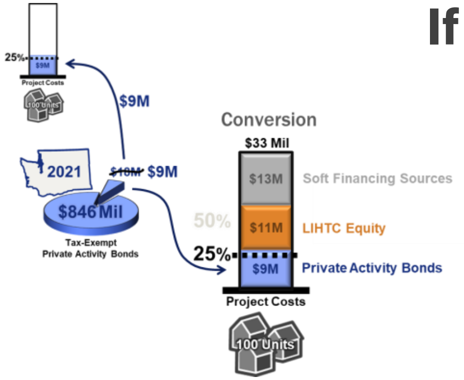
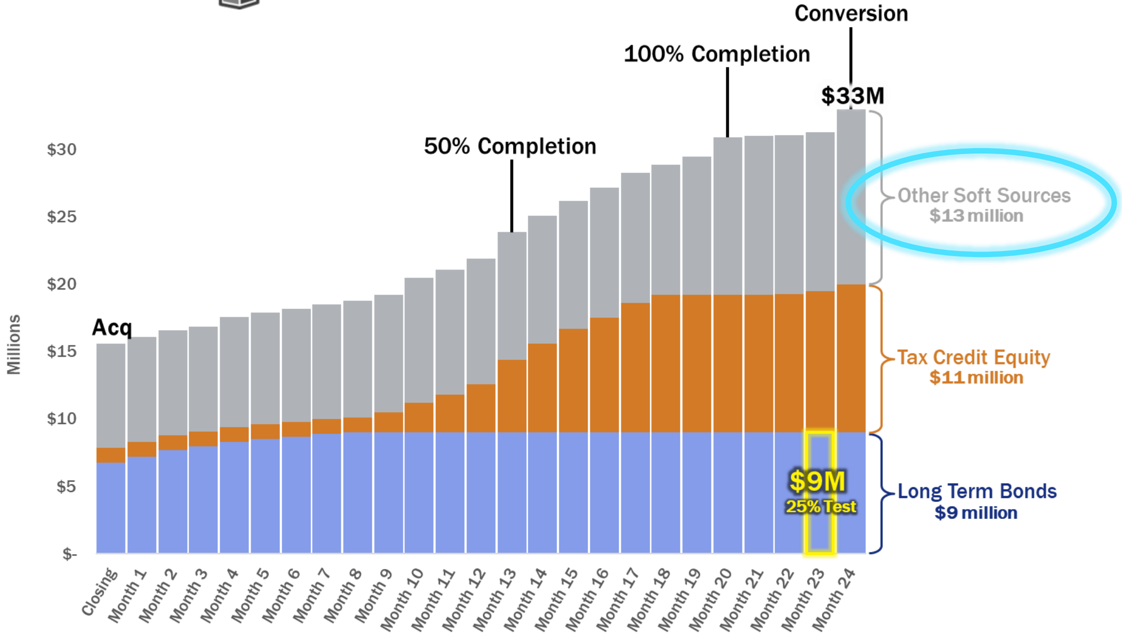


With a 25% "financed by" threshold, the financing sources as of conversion remain the same: $9 million in bond debt, $11 million in tax credit equity, and $13 million in other soft sources. However, as stated previously, $9 million in bond volume cap is freed for other units.

The absence of the $9 million requires the tax credit investors to contribute more equity earlier in the process or find other funding to bridge any financing gap between closing and conversion. Doing so is easier in times with low interest rates, when borrowing is less expensive.

If “financed by” threshold is lowered to 25%...

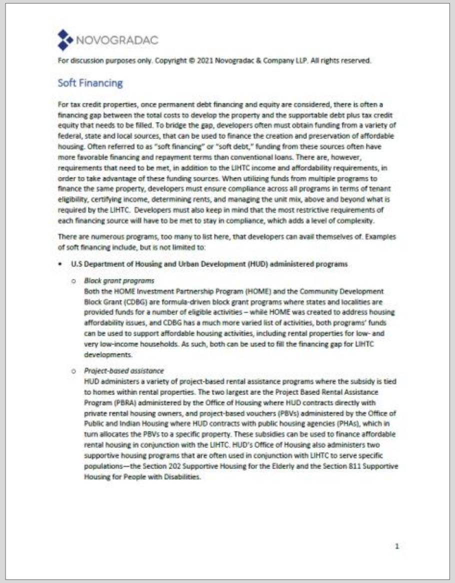




Soft Financing Options

- HUD-administered programs
  - Block grants
  - Project-based assistance
  - Assistance to special needs populations
- USDA multifamily housing programs
- Federal sources authorized by FHFA
  - National Housing Trust Fund
  - Capital Magnet Fund
  - Affordable Housing Program
- State and local sources
  - State LIHTC Programs
  - State and local affordable housing bonds
  - Other state and local sources
- Deferred developer fees
- Seller notes

Soft financing options are outlined here and explained in further detail in the attached document.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Soft Financing

For tax credit properties, once permanent debt financing and equity are considered, there is often a financing gap between the total costs to develop the property and the supportable debt plus tax credit equity that needs to be filled. To bridge the gap, developers often must obtain funding from a variety of federal, state and local sources, that can be used to finance the creation and preservation of affordable housing. Often referred to as "soft financing" or "soft debt," funding from these sources often have more favorable financing and repayment terms than conventional loans. There are, however, requirements that need to be met, in addition to the LIHTC income and affordability requirements, in order to take advantage of these funding sources. When utilizing funds from multiple programs to finance the same property, developers must ensure compliance across all programs in terms of tenant eligibility, certifying income, determining rents, and managing the unit mix, above and beyond what is required by the LIHTC. Developers must also keep in mind that the most restrictive requirements of each financing source will have to be met to stay in compliance, which adds a level of complexity.

There are numerous programs, too many to list here, that developers can avail themselves of. Examples of soft financing include, but is not limited to:

- **U.S Department of Housing and Urban Development (HUD) administered programs**
  - *Block grant programs*
    Both the HOME Investment Partnership Program (HOME) and the Community Development Block Grant (CDBG) are formula-driven block grant programs where states and localities are provided funds for a number of eligible activities – while HOME was created to address housing affordability issues, and CDBG has a much more varied list of activities, both programs' funds can be used to support affordable housing activities, including rental properties for low- and very low-income households. As such, both can be used to fill the financing gap for LIHTC developments.
  - *Project-based assistance*
    HUD administers a variety of project-based rental assistance programs where the subsidy is tied to homes within rental properties. The two largest are the Project Based Rental Assistance Program (PBRA) administered by the Office of Housing where HUD contracts directly with private rental housing owners, and project-based vouchers (PBVs) administered by the Office of Public and Indian Housing where HUD contracts with public housing agencies (PHAs), which in turn allocates the PBVs to a specific property. These subsidies can be used to finance affordable rental housing in conjunction with the LIHTC. HUD's Office of Housing also administers two supportive housing programs that are often used in conjunction with LIHTC to serve specific populations—the Section 202 Supportive Housing for the Elderly and the Section 811 Supportive Housing for People with Disabilities.

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