LOW-INCOME HOUSING TAX CREDIT PROJECT
CASE SCENARIO

OVERVIEW: The purpose of this section is to provide a case scenario to illustrate the general concept and procedures involved in developing a 60-Unit Low-Income Housing Tax Credit (LIHTC) Project. This scenario is based upon our experience with several other similar LIHTC Projects.

PROJECT EXAMPLE: For purposes of this discussion assume we are developing a 60-unit LIHTC Project. Past experience has indicated that the development "hard cost" to produce these projects are approximately $36,000 per unit, not including the cost of land. The Total Project Cost (hard and soft costs) are estimated to be $52,000 per unit. We are also assuming that the construction and permanent financing do not involve the use of Tax-Exempt Housing Revenue Bonds, or other Tax-Exempt financing. This will enable the Project to qualify for an annual tax credit rate of "9%" rather than "4%".

INTERNAL REVENUE CODE SECTION 42 (IRC §42): A central element of our proposal is the utilization of Low Income Housing Tax Credits (LIHTC) as provided under the guidelines established within IRC §42. At the time of this writing IRC §42 has expired as of June 30, 1992 but is expected to be reinstated into permanent law under President Clinton. This proposal assumes that Congress will pass IRC §42 and that it will be effective retroactive to June 30, 1992.

In general, the Federal Government will provide tax credit incentives to developers to stimulate the production of affordable housing. It is the syndication of these tax credits that provide the Investment Group with the "equity" needed to build and buy-down the permanent mortgage and enable the project to operate under the affordable rent structures as stipulated within the previous IRC §42 Income Guidelines.

The procedure for calculating the Tax Credit proceeds, or equity, can be explained after reviewing the following terms:

Eligible Basis - For purposes of this discussion let us simply state that the eligible basis of a given LIHTC Project are the Total Costs less the cost of the land and some soft cost.

Qualified Percentage Rate - This is a percentage rate that reflects the number of units rented to qualified low income tenants, as a percentage of the total units within the project. Federal law requires that you meet tests known as a "20-40 test" or a "40-60 test". For simplification, and as a practical matter to maximize the potential credits, we will assume that all units will be leased to qualified income tenants, therefore the qualified percentage rate used will be 100%.

Applicable Rate - This is the percentage rate used multiplied times the eligible basis to give us the annual tax credit. As stated above, our proposal seeks to use conventional financing rather than Tax-Exempt financing. Therefore the applicable rate used will always be 9%.

Present Value Rate - This reflects the worth today of the annual Tax Credits allowed over the next ten years, in terms of its net present value. This figure can vary anywhere from 38% to 50% depending upon the type of syndication arrangement.

Now that the basic terms have been defined, lets proceed with an example. A 60 unit LIHTC Project is proposed with land costs of $250,000 to be built with conventional financing, leased solely to qualified income tenants, with the worth of tax credits based upon a net present value rate of 45%. This example would provide Equity Proceeds calculated as follows:

Total Project Cost 60 units X $52,000/unit	$3,120,000	
Less: Ineligible Costs	340,000	(Land & Some Soft Cost)
Equals: Eligible Basis	$2,780,000	
Times: Qualified Rate	100%	
Equals: Qualified Basis	$2,780,000	
Times: Applicable Rate	9%	
Equals: Annual Amount	$ 250,000	Annual Tax Credit (Maximum)
Times: 10 year period	$2,500,000	Total Credits
Times: Present Value Rate	45%	
Equals: Equity Proceeds	**$1,125,000**	

TAX SYNDICATED LIMITED PARTNERSHIP: The $1,125,000 represents the Equity Proceeds, or net present value, of the annual tax credit of $250,000 that would "Flow-Thru" each year for the next 10 years, into a newly formed Limited Partnership arrangement with the Tax Syndicator. These equity proceeds are considered "Contributed Capital" by the Tax Syndicator (Limited Partner) in exchange for 99% ownership of the LIHTC Project. The Investment Group would remain as the General Partner (1%), but would negotiate a share of the cash-flow from operations and reserve the management rights (if qualified). In theory, the Equity Proceeds should be used to "buy down" the permanent mortgage which in turn allows for reduced rents to be charged to the Low-Income qualified tenants. However, because of the high-median income and market rents in parts of Minnesota, a full buy-down of the mortgage may not be necessary to maintain the required debt service coverage and still comply with Government guidelines. Especially if Tax Increment Financing (TIF) is available.

TAX SYNDICATION AGREEMENTS: Agreements in the Tax Syndication process are designed primarily to protect the financial commitment made by the Limited Partners. They may include: 1). An Investment Agreement that stipulates the plans and physical specifications of the LIHTC Project to be built 2). A Security Agreement that acknowledges the "Secured Interest" that the Limited Partners have in the "Collateral" in relation to the Debtor 3). An Indemnity Agreement to protect each other in the course of the development process should either party fail to perform due to specific circumstances 4). The Lease-up and Development Agreement that specifies the amount of Rent Reserves and Developer Fees to be held in escrow during initial marketing which will be disbursed only after certain rent levels are achieved and maintained for a specified period of time 5). The Final Partnership Agreement which defines the responsibilities of all Parties and the method of arbitration to remedy disputes. This document will include the agreed procedures of accounting, allocation, cash disbursements, tax compliance, replacement reserves, management decisions, Incentive Fees, as well as the division of proceeds from a sale, re-finance, or dissolution of the LIHTC Project.

LIMITED PARTNERS: The Tax Syndication Group as Limited Partners are by law "limited" in personal liability to the extent of their Capital Contribution Account (Obligation). They share on a pro-rata basis (99%) in Tax Credits and Tax Losses of the LIHTC Project. Their 99% share of Non-Recourse Debt (Mortgage) provides them the additional Tax Basis they need (if necessary) to benefit from the Tax Losses. They can not assume any recourse debt, provide personal guarantees, or participate in Management decisions.

The philosophy of Limited Partners is to invest in a "safe" project that has qualified property management, adequate debt service coverage, ample replacement reserves, annual tax credits as projected, annual tax benefits (losses) and enough cash when sold to pay for any "Income Recapture" or "Minimum Gain" for tax purposes. They obviously wish to avoid any Risk or adverse position where they may be forced to "take back" a project.

GENERAL PARTNERS: The Investment Group as General Partners bear the risk of any Recourse Debt and Personal Guarantees associated with the Project. They must demonstrate that they can maintain a debt service ratio of 1.15 or better, over the 15 year compliance period (see projections). They will be subject to an Operating Deficit Account Agreement, as General Partners, to safeguard the Limited Partners against default of obligations due to insufficient cash-flow from operations.

LONG-TERM vs EXIT STRATEGY: The Investment Group will have to decide if it wishes to remain in a partnership relationship with a Tax Syndicated Partnership to share in future cash-flows and management rights, or if it would prefer to "cash-out" by selling the total LIHTC Project. A 100% sale under normal circumstances should at a minimum provide the Investment Group a reasonable developer fee with no further interest in management rights or future cash flows. They are still contractually obligated to build, secure permanent financing, and achieve rent levels before they will be paid.

PROJECT FINANCE & PROFIT SCENARIO

CONSTRUCTION FINANCING: Whether your preference is to "cash-out" or enter into a Partnership relationship, the Investment Group must still perform their development and lease-up obligations. The scenario outlined below is presented as a "typical" project development. Actual financing arrangements will vary depending upon the total financial strength of the Investment Group, the liquidity of their assets, development history and their existing relationships with the banking community.

Let's continue with our example of a 60-unit project. The Construction Sources and Uses would be $2,800,000 as follows:

Sources:		
	Construction Loan Proceeds: (loan to cost 75%)	$ 2,100,000
	Equity by Investment Group (25% equity required)	700,000
	Total Funding Sources	$ 2,800,000
Uses:		
	Hard Cost: (60 units @ $36,000/Unit)	$ 2,160,000
	Cost of Land (approx. $1/sq ft)	250,000
	Our Sub-Developer Fee ($2,500/Unit @ 60-units)	150,000
	Other Costs: (Points, Fees, Reserves)	240,000
	Total Construction Uses	$ 2,800,000

Please refer to the supplemental schedules provided for an itemized listing of Project cost. Traditionally, we are assuming that the lender will require at least 25% equity in order to obtain the construction loan. The equity may be in the form of cash or letter of credit (LOC), if acceptable to the lender.

The construction period is estimated to last anywhere from 6 to 9 months, depending upon what time of year the construction begins.

PERMANENT FINANCING: The Permanent Loan closing should take place after the issuance of a Certificate of Occupancy (CO) and 95% Lease-up. Usually the units are 100% pre-leased before CO, with a waiting list of 50% (30 Units). The Permanent Loan will typically be 75% of the lessor of the appraised value as determined by an MAI, or the total project costs. The total project cost should be around $3,120,000 ($52,000/unit X 60 units), which include the amounts listed below except the Developer Fee. The Permanent Loan proceeds over Construction costs will include the following:

Developer Fee (7.5% of Total Cost)	$ 210,000	(Per MHFA Limit)
Operating Reserve	90,000	(Approx. 3% of Cost)
Replacement Reserve	90,000	($1,500/unit X 60)
Points & Other Fees	110,000	
Total	$ 500,000	

We will assume that the Project is appraised at $3,300,000 ($2,800,000 plus $500,000) which includes the Developer Fee of $210,000. We propose that the Permanent Loan will be originated at 75% Loan-to-Value, or $2,475,000. This amount will pay-off the Construction Loan of $2,100,000 but the Project has also incurred an additional $290,000 of cost (excluding Developer Fee).

EQUITY POSITION OF INVESTMENT GROUP: After Permanent Loan Closing the Investment Group will have $615,000 of cash equity into the Project and a Total Equity Position of $825,000 summarized as follows:

Previous Cash Equity at Construction Closing	$ 700,000	(Initial Investment)
Additional Soft Costs	290,000	
Less: Net Loan Proceeds $2,475,000 minus $2,100,000	(375,000)	
Cash Equity Position:	**$ 615,000**	
Plus Developer Fee (MHFA)	210,000	
Total Equity Position For Loan Purposes (25%)	**$ 825,000**	

The Developer Fee enhances the Equity Position to substantiate a 75% Loan-to-Value Ratio. Now let's focus our attention on how the Cash Equity of $615,000 is returned, as well as payment of the Developer Fees.

TAX CREDIT PROCEEDS: At this point we must now take into account the Tax Credit Proceeds of $1,125,000 (page two) that are contributed into the Tax Syndicated Limited Partnership. These funds will be contributed after the issuance of the CO, Permanent Loan Closing, and a rental achievement of 95% occupancy sustained for a specified period of time. This "hold-back" period will vary per Tax Syndicator, but we know through experience that the period of time and amount withheld will lessen per project as the General Partners demonstrate their consistent ability to market and pre-lease the LIHTC units.

PROFIT MADE BY INVESTMENT GROUP: The net profit made by the Investment group under this case scenario is $510,000 (Before Taxes) itemized as follows:

Sources:	Tax Credit Equity Proceeds	$ 1,125,000	($2,500,000 X 45%)
Less:	Return of Cash Equity	$ 615,000	(Loan Repayment)
Equals:	Gross Developer Fees (Net Cash-On-Cash Return)	**$ 510,000**	(Includes $210,000 Fee per MHFA)

The Cash Equity would be returned as a Loan Repayment to the Investment Group by the Tax Syndicated Limited Partnership, which is a non-taxable cash disbursement. The remaining $510,000 would be disbursed as a Developer Fee to the General Partner. This fee is subject to income taxes. The Syndicated group would require that this amount be classified as a developer fee in order that it be deductible to the Partnership. Our Sub-Developer Fees paid at Construction Closing were of course included within the Eligible Basis of the Project for purposes of calculating the total Tax Credits.

Using a worst case scenario of a Construction Period of 9 months and a Hold-back period of 6 months, the Investment Group would still experience an internal rate of return (IRR) of more than **60%** using a Cash-on-Cash basis (Before Taxes).

CO-VENTURE EQUITY: Tax Syndicators will contractually commit to the investment and development of future LIHTC Projects with the General Partners as they establish a good track record. This could mean the advancement of up to 30% of the Equity Proceeds before construction begins. In our example, this could be around $337,500. Obviously, this kind of relationship should be nurtured since this would represent almost half of the initial equity required during the construction phase.

FACTORS of INVESTMENT PROFITS: An Investment Group must not only consider the $510,000 cash-on-cash gain listed above, but must also value the following: 1) ongoing management fees which range from $20,000 to $30,000 a year, if the Investment Group can qualify as the Property Manager. 2) the net cash flow from operations (see projections) 3) the "Buy-Out" provisions, using Recapture, Minimum Gain, or some other formula to obtain full ownership of the project after the 15 year compliance period, thereby retaining subsequent cash-flows previously shared with the Limited Partners.

ASSUMPTIONS: We have been informed of some Projects that may be financed with less equity requirements, or receive a better Tax Syndication Rate (55%), which would allow for greater IRR figures. We acknowledge that these other possibilities should be diligently pursued, however, this case scenario is presented to reflect a reasonable and accurate example of the LIHTC Development Process. We also acknowledge that some potential risk factors do exist. The Investment Group must consider possible excess cost overruns, higher mortgage interest rates, lower loan to value ratios and other circumstances that create variables that are essentially "moving targets" when trying to accurately predict the Investor's potential profit.

CONCLUSION: Our goal is to develop a working relationship with an Investment Group that seeks to explore the potential market and financial rewards associated with building LIHTC Projects. We welcome this opportunity to present this proposal in an effort to initiate further discussions. We encourage you to seek professional advise in this matter and welcome any questions you may have.

End of Memorandum: LIHTC Case Scenario

22. PROJECT COSTS - MUST BE FILLED IN

List and indicate eligible basis by credit type. (Residential Portion Only)

Itemized Cost	Actual Cost of All Units	Adjustment for High Cost Areas	Eligible Basis By Credit Type* 30% PV Eligible Basis	70% PV Eligible Basis
To Purchase Land and Buildings				
Land	250,000	N/A	N/A	N/A
Existing Structures		N/A		
Demolition				
Other				
For Site Work				
Site Work	220,000			
Off Site Improvement	40,000			
Other				
For Rehabilitation and New Construction				
New Building	1,944,000			
Rehabilitation				
Accessory Building garages	above			
General Requirements	40,000			
Contractor Overhead	30,000			
Contractor Profit	above			
Other accounting	10,000			
For Contingency				
Construction Contingency	75,000			
Other				
For Architectural and Engineering Fees				
Architect Fee - Design	16,000			
Architect Fee - Supervision	5,000			
Real Estate Attorney	16,000			
Consultant or Processing Agent				
Other Fees Civil Engineer	4,000			
Other Fees Mechanical	4,000			
Other Fees Soil tests	7,000			
Other Fees Survey/reimbrus	7,000			
For Interim Costs				
Construction Insurance	10,000			
Construction Interest	60,000			
Construction Loan Origin Fee	36,000			
Constr. Loan Credit Enhancement				
Taxes	4,000			
For Financing Fees and Expenses				
Bond Premium				
Credit Report	1,000			
Permanent Loan Origin Fee	30,000		N/A	N/A
Perm Loan Credit Enhancement			N/A	N/A
Cost of Iss/Underwriters Discount				
Title and Recording	10,000			
Counsel's Fee	15,000			
Other				
Other				
SUBTOTAL	$ 2,834,000			$ 2,554,000

*The 30% P.V. and 70% P.V. refer to credit type. Do not multiply by 30% or 70%.

22. PROJECT COSTS (CONTINUED)

Itemized Cost	Actual Cost of All Units	Adjustment for High Cost Areas	Eligible Basis By Credit Type: 30% PV Eligible Basis	70% PV Eligible Basis
For Soft Costs				
Property Appraisal (Feasibility)	$ 6,000			
Market Study				
Environmental Report	2,000			
Tax Credit Fees	14,000			
Rent-Up			N/A	N/A
Consultants				
Other City fees	15,000			
For Syndication Costs				
Organizational (Partnership)	15,000		N/A	N/A
Bridge Loan Fees and Expenses			N/A	N/A
Bridge Loan Interest				
Tax Opinion	10,000		N/A	N/A
Other	2,000			
For Developer's Fees - Total developers fees, overhead or other payment to Developer cannot exceed maximum. In Procedural Manual.				
Developer's Overhead				
Developer's Fee 7.5%	$ 210,000			
Other				
For Project Reserves - See Below				
Rent-Up Reserve			N/A	N/A
Operating Reserve			N/A	N/A
Other				
Other				
Other				
SUBTOTAL	$ 274,000			249,000
SUBTOTAL PREVIOUS PAGE	$ 2,834,000			2,554,000
TOTAL	$ 3,108,000			$ 2,803,000

	30% PV	70% PV
Less portion of federal grant used to finance qualifying development costs. List Grants ______	( )	(N/A)
Less amount of nonqualified nonrecourse financing	( )	( )
Less non-qualifying units of higher quality	( )	( )
Less non-qualifying excess portion of higher quality units	( )	( )
Less Historic Tax Credit (Residential Portion Only)	( )	( )
TOTAL ELIGIBLE BASIS		$ 2,803,000
Multiplied by the Applicable Fraction (See pg. 17 also)	%	100 %
TOTAL QUALIFIED BASIS		2,803,000
Multiplied by the Applicable Percentage	%	9 %
TOTAL AMOUNT OF TAX CREDIT REQUESTED* (Annual Maximum Credit Allowed= $250,000)		$252,270

(PLEASE NOTE: The actual amount of credit for the project is determined by the housing credit agency, at each evaluation stage.)

If the project is eligible for Historic Tax Credit include a complete breakdown of the determination of eligible basis for the Historic Credit with the application. If the Project's basis has been adjusted because it is in a high cost or qualified census tract, the actual deduction for the item(s) must be adjusted by multiplying the amount by 130%. This does not apply to Historic Tax Credits. For required letters of credit, bonds, etc. for reserves, rent up, working capital, guarantee, etc. use the actual cost not the face value.