LOW INCOME HOUSING TAX CREDIT
"INVESTOR SIDE" ANALYSIS

I. Investors potential return from investment consist of the following items:

A. Utilization of tax benefit from low income housing credit - typically split 99-1;
B. Utilization of net losses or deductions generated from project operations* c-corps only;
C. Distributions of cash flow from operations;
D. Distributions of sale and/or refinancing proceeds;
E. Social policy considerations: CRA credit or community involvement.

II. Investors have difference ways of analyzing overall yield based upon the combination of the benefits to be derived.

A. Internal Rates of Return ("IRR") Some investors (participating institutional type investors) utilize target IRRs in order to make investment decisions. Typically IRR's should be 15% or greater. Obviously IRRs are subject to wide fluctuations depending upon a number of assumptions including reinvestment rates.

1. Utilization of deferred payment option. In order to increase IRRs to investors without reducing pay-ins to qualifying projects deferred pay-ins or contributions are typically utilized.

Example: Partnership A has developed a qualifying low income housing project which generates $250,000 of credit per year which is allocated 99-1 to the investor limited partner. In order to increase the IRR to the limited partner, Partnership A and the Limited Partner decide to have the L.P.'s capital contributions extended over a period of time.

Total credits over a 10 year period $247,500 x 10 = $2,475,000 assume traditional pay-in lump-sum up front $2,475,000 x 50% = $1,237,500.

Single pay-in of $1,237,500 for annual benefit of $247,500 for 10 years has an IRR of approximately 15.1%.

If the investors or the partnerships cost of borrowing is less than 15%, deferred payments can simultaneously increase yield to investor and pay-ins to partnership.

EXAMPLE

	Lump Sum	Deferred Method
$247,500	$1,237,500	$346,500
$247,500		$346,500
$247,500		$346,500
$247,500		$346,500
$247,500		$346,500
$247,500		
$247,500		
$247,500		
$247,500		
$247,500		
Gross Pay-In	$1,237,500	$1,732,500
IRR to Investor	15.1%	20.43%
P.V. of Payments @ 10%	$1,237,500	$1,317,298

2. Deferred pay-in can be externally financed i.e., L.P. gives Partnership A a note representing its obligation to make deferred contributions. Partnership then takes the investor note and pledges it as security for a loan from a lender;

    a. Note must be unconditional or it will not be bankable by Partnership;

        (1) tax credit adjusters

    b. credit worthiness of investor becomes an issue.

3. Deferred pay-in may be internally financed, in which case Limited Partner borrows money from a third party to finance their investment and pays a single lump sum into the partnership.

4. Deferred pay-ins used for other reasons:

    a. To insure project stability and as a guarantee of developer or sponsor performance typical national syndicator pay-in:

        (1) 40% @ financing closing
        (2) 30% @ construction completion

(3) 20% @ rent-up and 8609 completion
(4) 10% @ specified debt coverage ratio such as 1.1 - 1.0

5. Deferred pay-ins are also used as in retail type syndications to individuals for affordability; 2-3 years for retail; 6 years or longer for institutional.

a. Annual yields or credit as a percentage of investment. Investors will sometimes list target investment in the range of annual yields (12-18% or ratios of credit to total investment (i.e. 1.5-1.75).

(1) For example 200,000 annual low income housing credit generated by qualifying development. On this target investment analysis the investor would pay $1,500,000 on an up-front single pay basis to be within its target of 15%.

(2) Investor would pay $1,250,000 to be within its target of 1.60 - 1 credit ratio.

(3) This can create an issue in dealing with the years subsequent to credit period.

III. Investors position in other economic attributes investors typically insist on:

A. annual preference in cash flow for maintenance or asset management frees $8,000 - $15,000 per year;

B. 50% interest in cash flow;

C. preference on 100% of sales and refinancing proceeds until initial investment returned.

LOW INCOME HOUSING CREDIT
DEVELOPER SIDE ANALYSIS

I. General Developers ordinarily measure the benefit they derive from the sale of the limited partner equity interest in terms of a "cents on the dollar" basis, i.e. $250,000 annual credit yields .60 on the dollar to developer if total pay-in was $1,500,000. ($1,500,000 divided by $2,500,000).

II. Fees Development fees realized for assembly of project financing and developing the project are a function of the total debt and equity financing which can be obtained.

A. Developer typically incurs cost throughout a 9-18 month development period.

B. Upon placed in service date or construction completion most it not all developers investment is refunded.

C. Total fees includable for state housing credit aging purposes are limited.

1. New construction and substantial rehabilitation fees 15% of total development costs for first 50 units 8% thereafter.

2. Fees may be deferred for reasons related to deferred investor pay-ins;

a. basis issues created by deferred fees particularly for investors subject to at risk rules.

D. Methods for evaluation:

1. Are these competent tax professional associated with the transaction which have been involved with the tax analysis and planning for the development?

2. Are the target rates of return shown to be available competitive and do they consist of a significant amount of non tax benefits. If so should they be discounted?

3. Do the general partners have a meaningful track record in real estate development and tax credit project in particular?

4. Does the project have long term fixed rate financing?

5. Do the general partners have significant ongoing risk or exposure with respect to the development?

6. Are there adequate up-front operating and replacement reserves as well as required annual additions for replacement reserves in the future?

AT RISK ISSUES

I. The at risk rules are an attempt to limit the amount of financing included in the credit basis to a 3rd party objective limitation. In general Section 42(k)(1) proves that rules similar to the rules at Section 49(a)(1) and 49(a)(2) (with certain exceptions) shall apply in determining the credit basis of qualifying property.

A. Exceptions to general at-risk rules is at 49(a)(1)(D)(ii)(II) and (D)(iv)(I) do not apply for low income housing tax credit purposes.

B. 49(a)(1) provides that the credit basis of otherwise qualifying property is reduced by eliminating financing which is not "qualified commercial financing."

C. Qualified commercial financing is defined under Section 49(a)(1)(D)(ii) to situations where:

   1. the property on which credit is claimed is acquired by the taxpayer from a person who is not a "related person"; and

   2. is borrowed from a qualified person or represents a loan from any federal, state or local government or instrumentally thereof.

D. Qualified person is defined under 49(a)(1)(D)(iv) as an entity actively and regularly engaged in the business of lending money and which is not:

   1. a person from whom the taxpayer acquired the property; or

   2. a person who receives a fee with regard to the taxpayers investment involvement in the property.

II. Conclusion: For low income housing tax credit purposes the only financing which is includable is financing borrowed from a commercial lender not related to the seller of the property and to whom no other fees are paid.

A. Definition excludes (i) seller financing, and (ii) financing provided by developer i.e. deferred development fee and (iii) lender financing.

B. Rules applicable to individuals and closely held C corporations.

   1. Closely held C corps are those in which at any time during the last six (6) months of the fiscal year 50% of the outstanding stock is owned, directly or indirectly by two or fewer individuals.

C. At risk rules under Section 49 do not apply to widely held C corporations as such, widely held C corporations enjoy a comparative advantage relative to transactions involving seller financing and deferred development fees.

D. Example Partnership A acquires a qualifying building from Partnership B for a total purchase price of $5,000,000. In order to assist in the financing and acquisition Partnership, B "took back" $1,000,000 in subordinated seller

42(h)(1)(E) provides that the credit may be carried over to a subsequent year in the event that at least 10% of the projects "reasonably anticipated basis" is incurred by the end of the year in which the credit is received.

1. Satisfied with land cost, architectural engineering, and development fee accruals.

C. Recapture of credit and loss of future credit due to foreclosure of mortgage.

1. Most investment will yield above market rates even if none of the economic benefits are available i.e., based on credit return alone.

D. Eligible basis reductions. Costs included in eligible basis but disallowed upon audit examples include:

1. Development fees as organizational or syndication costs or deferred development fees;

2. Problems satisfying 10 year rule for qualified acquisition costs;

3. Financing costs; and

4. Federal subsidiaries not excluded from basis due to expenditure on non-basis costs.

E. First year credit risks. Pursuant to Section 42 of the Code, credit earned during the first year of the credit period is based upon actual occupancy during the year.

1. Credit based upon number of months units were actually occupied by qualified tenants;

2. Disallowed credit available in 11th year.

II. Other risks:

A. Lack of long term competitive product due to inadequacy of reserves.

B. Rent and income levels which do not increase as a result of prolonged economic problems.

C. Developer or management failures.

III. Guarantees. Investors typically receive guarantees of various types from developer/sponsors. There is a fair amount of uniformity in the type of guarantees given including the following:

A. Guarantee of construction completion in accordance with plans and specifications;

B. Guarantee of tax benefits;

C. Guarantee of operating deficits typically limited to 2-4 years after placed in service;

D. Security for guarantees consists of letters of credit and deferred installments by investors as well as cash revenues.

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EXHIBIT I

Investor Matrix: Income Characterization and Ability to Use the LIHC

Character of Income	Investor Type				
	Individual[1]	Corporation[1]	Tax-Exempt	Trust	Estate
Passive	Yes	Yes	Yes	Yes[2]	Yes
Portfolio	Yes[3]	Yes[4]	No	No	No
Active	Yes[3]	Yes[5]	No	No	No

(1) Special rules apply to individuals and corporations in "real property trades or businesses."

(2) The LIHC can be used to offset regular tax to the extent that passive income is taxed at the trust level.

(3) For investments made before 1990 or for property placed in service before 1990, the LIHC can be used to offset regular income taxes if the taxpayer's adjusted gross income (AGI) is less than $200,000. The credit is limited to the top marginal tax rate times $25,000. (Generally $9,900 [39.6% × $25,000]). For pre-1990 investments, if AGI exceeds $200,000, then this $25,000 allowance is reduced by 50 cents for every dollar of such excess. For investments made after 1989 for projects placed in service after 1989, the phaseout is not applicable. See Chapter 3 for additional discussion of this rule.

(4) The LIHC can be used to offset regular income tax on portfolio income only if the corporation is widely held.

(5) The LIHC can be used to offset regular income tax only if the corporation is not an S corporation and is not a personal service corporation.