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Pricing the Equity of a Tax Credit Project: An Institutional Investor's Perspective

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The creation in 1986 of the low income housing tax credit (LIHTC) has profoundly changed the multifamily housing industry in the United States. The LIHTC program has become the key vehicle for the production of rental housing that meets the needs of low-income households.[1] Since 1986, over 1,800,000 affordable housing units have been built or rehabilitated using the LIHTC program.[2] Annually, the LIHTC produces approximately 90,000 new or renovated housing units at a cost to the taxpayers estimated at $5 billion.[3] About 40 percent of all rental housing is now financed in part through the LIHTC.[4]

The LIHTC subsidy has given rise to an industry centered on taking advantage of the LIHTC. The industry includes developers that build LIHTC projects, syndicators that acquire and resell equity interests that generate LIHTCs, and advisors and professionals who provide services to industry participants. As the LIHTC industry developed, a highly competitive market has emerged for the acquisition of equity interests in LIHTC projects. The market is dominated by syndicators that invest in entities that own LIHTC projects and resell equity interests to companies that can efficiently utilize the LIHTCs and other tax benefits of these projects–primarily widely held Subchapter C corporations.[5] Some syndicators have sold public funds to both corporate and individual investors. In addition, direct acquisition of equity by corporate investors has become an important factor in the marketplace. Banks, utility companies, and other corporate investors often pursue projects near their headquarters to foster good community relations and to seek an attractive return on equity. As the number of syndicators and direct

corporate purchasers has expanded, the markets have become more efficient. Consequently, the cost of equity has fallen.

Often, the value of LIHTC investments is described in terms of a price per credit. For example, one industry source recently noted that tax credit "prices have been high, often in the 90-cent range for a dollar's worth of credit."[6] The practice of using a single price per credit figure belies the difficulty of valuing LIHTC investments. This article describes the factors that are important in valuing an LIHTC investment and discusses how an appreciation of the complexities and nuances of an LIHTC investment can improve the decision-making process for LIHTC investment.

An Overview of the LIHTC

The LIHTC is a dollar-for-dollar tax credit that offsets the federal income tax liability of the taxpayer. Assuming compliance with the intricate provisions of section 42 of the Internal Revenue Code, the taxpayer will receive a stream of tax credits each year for a ten-year "credit period."[7] Failure to comply with section 42 requirements at any time during the fifteen-year "compliance period" can result in recapture of credits previously taken.[8]

Generally, a project owner obtains an allocation of LIHTCs from the appropriate state housing credit agency, which allocates tax credits through an intensely competitive process. Projects financed with tax-exempt bonds are not required to compete under the state allocation process, but must demonstrate that the utilization of the LTHTC is necessary to make the development feasible.[9] The LIHTC is available to finance new construction and the substantial renovation of existing housing.[10]

Section 42 imposes both rent restrictions and tenant income limitations.[11] As a threshold to receiving tax credits, a project must satisfy one of two minimum set-aside tests: either (1) at

least 40 percent of the units constitute low income units when "low income" is based on 60 percent of area median income; or (2) at least 20 percent of the units constitute low income units when "low income" is based on 50 percent of area median income.[12] The majority of LIHTC projects are subject to the 40-60 minimum set-aside test. Under the section 42 rent restrictions, a housing unit's rent may not exceed the level at which it is affordable at the median rent level chosen for the minimum set-aside test. For example, if the 40-60 election is made for a project, then the rents (including a utility allowance) for the low income units in the project must not exceed 30 percent of 60 percent of area median income. In addition, the low income units must be rented to persons whose income does not exceed the applicable guidelines (e.g., 60 percent of area median income in the case of a 40-60 project). The LIHTC program involves many complicated rules regarding the application of rent restrictions, tenant income limitations, and other tenant eligibility standards.

The calculation of the LIHTCs available to a project depends on a number of factors. Generally, the aggregate LIHTCs available for a project can be calculated as the product of the following attributes of the project: (1) its "applicable percentage," (2) its "applicable fraction," and (3) its "eligible basis." The most important determinant of a project's applicable percentage is whether the project is eligible for the "9 percent credit" or the "4 percent credit." Generally, a project that receives tax credits under the competitive state allocation process and that is not financed with any below-market federally subsidized debt is eligible for the 9 percent credit; a project that is financed with tax-exempt bonds or other "federal subsidies" is eligible only for the 4 percent credit.[13] The actual applicable percentage varies by month with interest rates, and for February 2006 the 9 percent credit is now 8.05 percent and the 4 percent credit is 3.45 percent.[14] The applicable fraction for a project is the lesser of the percentage of apartment units in the

project that are low income units or the percentage by floor space of the low income units.[15] A project's eligible basis is generally the project's depreciable basis for federal income tax purposes, including depreciable personal property.[16] Land costs, costs of obtaining permanent financing, and other nondepreciable costs will not generate tax credits.

Usually, LIHTC projects are owned by a limited partnership or limited liability company. These are the entities of choice because they provide for pass-through treatment of the tax credits, permit the special allocation of losses, and permit ownership by corporate entities. Typically, a developer entity acts as the general partner and the equity investor acquires the limited partnership interest. Usually, the developer general partner is a company with local or regional expertise in multifamily real estate. Often, the developer general partner is a charitable, governmental or other not-for-profit entity that develops and operates housing to meet the needs of the low-income community. Public housing authorities frequently act as the sponsor of projects using HOPE VI funds and other sources for the redevelopment of blighted public housing.

LIHTC Syndication

While the initial investor in some LIHTC project owners is an entity that plans to keep the investment to offset its own federal income tax liability, more often the initial investor is an LIHTC syndicator. The LIHTC syndicator acquires numerous properties, aggregates them in one or more funds, and sells securities in the funds to widely held C corporations, which use these new securities to offset their federal income tax liability. Direct investors include federally charted banks that acquire tax credit investments in part to qualify for community investment act credit, Fannie Mae, Freddie Mac and other mission based investors as well as economically

driven investors that believe that they can acquire a better product at a better price by direct investment.

The new tax credit security sold by a syndicator can vary substantially from the underlying investment in the LIHTC project owner. There are two general types of syndicated LIHTC securities – guaranteed and unguaranteed. The guaranteed security provides the investor with a guaranty of all or some portion of a projected yield on its investment by an investment grade guarantor or other credit enhancer. The addition of a guaranty changes the risk profile of the LIHTC security as it greatly reduces the investor's exposure to the risk of poor economic performance of the LIHTC project and to tax risk. The trade-off is that the tax credit investor receives a substantially lower yield from its investment than it would have received from a similar security without the credit enhancement. The unguaranteed security bears a greater resemblance to the underlying ownership interest in the LIHTC owner. Even the unguaranteed security typically mitigates the risk of direct investment in a single LIHTC project owner. By selling securities in a diversified pool of properties, the LIHTC investor can reduce its exposure to economic risk associated with a particular geographic market, developer or product type. A syndicated deal without a guaranty may involve the creation of a large reserve at the level of the syndicated entity that can be used to address problems arising from a default by the general partner of an LIHTC project owner, underperforming economic assets or other problems.

Components of Return

Every LIHTC investment is comprised of four basic components. First and foremost in the minds of most LIHTC equity investors is the stream of LIHTCs that the investor expects to receive during the ten-year credit period. Second, the investor should receive periodic distributions of funds from operations. Third, the investor should receive a distribution upon the

sale of the project, usually after the end of the fifteen-year compliance period. Fourth, the investor will receive periodic allocations of gains and losses from the project, including depreciation deductions, operating gains or losses, and gains or losses attributable to a capital event, including the sale of the LIHTC project. The basic equity pricing model based on price per LIHTC presumes that each dollar of LIHTC will correspond to a set level of expected distributions and tax allocations of gains and losses. In reality, this presumption does not reflect the experience of tax credit investors.

Factors Related to the LIHTC Program

Certain aspects of section 42 of the Code create a wide variation in cash flow distributions, residual sales value, and tax attributes per LIHTC dollar. One of the most important variables is whether the LIHTC project is a 9 percent credit project or a 4 percent credit project, such as a tax-exempt bond financed project. The 9 percent project is typically characterized by a high level of tax credit equity to debt. Bond financed projects will generate relatively more debt and less equity as a result of the lower interest rate on the bonds and the much lower tax credit equity per dollar of eligible basis. These differences tend to make the 9% relatively less susceptible to the economic performance of the asset. The relatively low equity generated by a tax-exempt bond financed project makes it more difficult to make these projects feasible. Consequently, the bond financed projects tend to get more scrutiny in the investor underwriting process. Moreover, the 4 percent credit projects are more likely to be limited to markets with relatively high rent levels or low construction costs. Sometimes the gap created by the relatively low tax credit value is bridged by subsidized debt financing or grants.

All projects that are eligible for LIHTCs must have an extended low income housing commitment in place, which obligates the owner to comply with section 42 rent restrictions and

income limitations for the entire thirty-year extended use period.[17] Although the minimum extended use period is thirty years, generally a project owner has the right after the fourteenth year of the compliance period to submit a "qualified contract" to the housing credit agency at a purchase price equal to the sum of the outstanding indebtedness secured by the project and the taxpayer equity increased by an inflation factor net of cash distribution previously made to the taxpayer. If the housing credit agency does not find a buyer within a one-year period, the owner can sell the project to a new owner, which will be allowed to raise the rents to market rents, subject to certain phase-out restrictions for the protection of existing tenants of the project.[18] Some states require that (or give additional points in the competitive allocation process if) the owner agrees to an extended use period exceeding thirty years and/or to waive its rights to submit a qualified contract or bring a project to market rents at the end of the compliance period. While these decisions adversely affect expected returns from cash flow after the compliance period and the expected return from a sale of the project, they promote public goals of the allocating housing credit agencies.

Participation by a nonprofit corporation in an LIHTC project can also affect equity values. Under section 42, a set-aside for nonprofit corporations has been established for not less than 10 percent of a state's allocation of LIHTCs.[19] It has been estimated that non-profit sponsors are involved with approximately one-third of housing developed in conjunction with the LIHTC.[20] An equity investor's valuation may be decreased based on a belief that the nonprofit corporation will not manage a project or generate cash flow or sales proceeds as effectively as a for-profit developer based on a lack of financial strength of the nonprofit corporation or based on the difficulty of removing and replacing a poorly performing nonprofit corporation. In fact, a nonprofit corporation that is exempt from federal income taxation must

manage and operate the project in a manner that serves its charitable purposes, even if this is at the cost of reduced economic performance.[21]

Other factors, however, make non-profit corporations highly desirable partners. In some markets, non-profits have developed a good reputation for the development skill and management abilities. In some states, a non-profits participation can qualify the entire LIHTC project from real property tax. For example, in California a partnership is exempt from real property tax if it owns an LIHTC project and has a non-profit managing general partner.

Some nonprofit corporations that act as general partners obtain from the owner a right to purchase the project at the end of the fifteen-year compliance period for a below-market price.[22] Moreover, some states have provided extra points in the competitive allocation process for projects that provide a right of first refusal or purchase option for a nonprofit corporation or a tenants' organization. While these rights have an adverse effect for the tax credit investor on potential proceeds of a sale and consequently on equity value, they do serve the public policy goal of providing for continued use of the project to serve the needs of low-income tenants event after the expiration of the LIHTC compliance period.

In urban areas where development costs are high and restricted rents are low, often LIHTC projects are financed by a combination of conventional debt financing and "soft" debt.[23] Typically, soft debt is below-market interest rate financing provided by a governmental entity or a nonprofit entity to make a project feasible. Often, soft debt is payable only from a portion of project cash flow or proceeds of a capital transaction. This aspect of soft debt adds value to the project because of the reduction in risk of project foreclosure. Deals financed with a combination of conventional and soft debt generally have higher depreciation deductions (because of the additional basis attributable to the soft debt) and lower cash distributions and

sales proceeds (because of the need to pay the soft debt) than projects financed only with conventional debt.

To provide additional incentives to develop projects in inner city urban and other high need areas, section 42 provides that projects located in "difficult development areas" and "qualified census tracts" are entitled to a 30 percent increase in eligible basis.[24] All other things being equal, projects that have the increase in eligible basis will tend to have lower cash returns than other LIHTC transactions because the increase in tax credits does not necessarily mean greater cash flow or residual value.

The mix of low income units and market rate units in the project is important when determining project value. In assessing the unit mix, the investor should consider whether restricted rents for low income units are substantially below-market rate rents. A project containing all low income units with rents that are substantially below-market rents should have extremely low vacancy rates and perhaps lower marketing costs. But a project with a substantial percentage of market rate units may have significantly higher net operating income than a physically identical, all low income unit project. A project that is comprised of all low income units will generally be able to raise rents based only on the annual increase in area median income. A project with a market based element, however, may be able to sustain a higher growth rate in rents over time, as the market rate units are not rent-restricted. The total number of multifamily units in the project also affects equity pricing. Many institutional investors prefer projects of at least 100 units to provide for more efficient management and a product more comparable to market rate institutional real estate. Many states give additional points in the competitive allocation process to projects that provide lower rents on low income units than

required under section 42. Projects that are subject to these additional rent restrictions generally will have lower values than projects that only face the section 42 requirements.

LIHTC projects sometimes qualify for state or local tax abatements. The tax abatement's effect on cash flow is usually factored into the equity investor's decision to purchase equity. The equity investor should also take into consideration the negative effect of the expiration or phase-out of the tax abatement on projected cash flows and on residual value.

LIHTC projects will vary in the amount of tax risk that they bear. For example, a project that has a carryover allocation based on a questionable determination that 10 percent of reasonably expected eligible basis was incurred could subject the investor to a total loss of tax credits.[25] As another example, the taxpayer's inclusion of certain costs and fees in eligible basis could be subject to challenge on audit and an adverse decision could result in loss of tax credits. The equity investor should consider unusual tax risk in making tax credit investment and pricing decisions.

Financing and Sponsor-Related Factors

As with any real estate investment, interest rate risk and other financing-related risks should be assessed when evaluating LIHTC investments. For example, investment in a project that has no commitment for fixed rate permanent financing would subject the equity investor to the uncertainties in obtaining a long-term loan prior to the expiration of the term of the construction loan. If interest rates are higher at the time of obtaining the permanent loan, the project may not qualify for the desired loan amount and/or the debt service expense may exceed the projected debt service at the time of the equity closing. Projects financed with tax-exempt bonds sometimes are financed with "low-floater bonds" that change in rate every week. This method of financing provides a substantially lower expected interest rate cost, but exposes the

owner to significant interest rate risk.

The specific terms of the program under which an LIHTC equity investment is offered affect the value of the equity investment. One important variable is the percentage of the operating distributions that the equity investor will receive. Another factor is how the tax credit investor participates in sales proceeds. In the current market, the developers typically retain most of the economic (non-tax) benefits of the project.

The package of warranties, guaranties, and financial assurances provided by the program sponsor to the equity investor affects the value of an LIHTC equity investment. Moreover, the financial strength and experience of the sponsor are crucial in assessing whether the assurances provided by the sponsor are in fact meaningful. The investor must ask a number of key questions in comparing investment opportunities offered by different sponsors. Regarding construction risk, does the sponsor guarantee timely completion on budget? If the sponsor funds a cost overrun, is the payment treated as a loan that must be paid back or rather as a reduction in the sponsor's fee?

As to the availability of tax credits, does the sponsor guarantee that the actual allocation of tax credits to the equity investor will match the tax credits projected in determining the price of the equity? Does the guarantee cover recapture of tax credits previously claimed? Does the sponsor guarantee to fund operating deficits to avoid a default and consequent loss of the tax credits? If so, on what terms would the sponsor fund these operating deficits? If the operating deficits are funded as loans, at what interest rate are operating deficit loans made and how are they repaid? These questions can be answered only by an analysis of the financial and legal structure of the various programs. They are important (but difficult to quantify) factors in making the investment decision.

Discounted Cash Flow Analysis and the Tax Credit Investment

A tax credit equity investment is a combination of an investment in a ten-year stream of tax credits and in a real estate project. The predominant model for valuing and comparing real estate investments is discounted cash flow analysis. Under one form of discounted cash flow analysis, the expected stream of cash flow, the proceeds of a sale after a projected holding period, and the tax attributes are reduced to a present value number, which represents the conclusion of value for the project. Alternatively, some investors prefer to compare the internal rates of return of competing projects as a guide to investment decisions. Under the internal rate of return method of discounted cash flow analysis, the analyst projects the expected stream of benefits and costs, including the amount and timing of capital contributions, and calculates the discount rate that will cause the present value to equal zero. This approach assumes that the investor will be able to reinvest distributions received prior to liquidation at the internal rate of return. A refinement on the internal rate of return form of discounted cash flow analysis is the adjusted internal rate of return, which presumes that benefits are invested at a presumed safe interest rate rather than the internal rate of return.[26] The adjusted internal rate of return method will yield results closer to the present value form of discounted cash flow analysis than will the simple internal rate of return model.

Discounted cash flow analysis is well suited to analyzing tax credit investments for a number of reasons. First, it considers all four components of return (tax credits, cash flow distributions, residual value, and tax attributes) and thus provides a reasonable method for comparing after-tax valuations of competing investments. Second, the discounted cash flow analysis permits the separate valuation of each component of return so that the investor can analyze the relative value of each component of the return it is acquiring (e.g., the investor can

assess the percentage of total valuation attributable to tax credits). Third, discounted cash flow analysis enables the investor to consider the particular type of financing that may be a key part of the particular tax credit investment. This feature is extremely important for proper analysis of projects that are financed with tax-exempt bonds or federally subsidized below-market debt. Finally, the flexibility of discounted cash flow analysis permits modeling of a special situation, such as the phase-out of a tax abatement.

The first step in discounted cash flow analysis is to model the expected costs and benefits from the particular investment. In the context of a tax credit investment, the projection of these numbers is complicated by a number of factors. The project income projections must be consistent with the rental restrictions applicable to the project under section 42 or other relevant restrictions. The stream of projected tax credit must be accurately modeled. In forecasting project income and choosing growth factors for income, one should consider rent restrictions under section 42 and any other applicable regulatory agreement or program. On the expense side of the equation, any property tax abatements, including the phase-out or expiration of them, should be accurately included in the projections.

One of the key decisions in conducting a discounted cash flow analysis is the choice of discount rates used in determining project value. The discount rate should consider the expected return an equity investor would demand for an investment with a risk profile similar to that of the tax credit project under analysis.

Sensitivity analysis is a technique that supplements discounted cash flow analysis. Generally, discounted cash flow valuation is based on the expected or the most likely outcome. Sensitivity analysis involves running discounted cash flow analysis using a range of assumptions about outcomes as well as the most likely case. It is particularly useful to "stress" a transaction

to see how values are affected by using less optimistic assumptions, such as lower growth rates for net operating income, higher interest rates on refinancing, or higher market capitalization rates in the project sales scenario. Because of the many variables involved in tax credit projects, sensitivity analysis can lead to a heightened understanding of the project.

Evaluating LIHTC Projects

The following examples illustrate how discounted cash flow analysis can be used to evaluate and compare investment return from three different LIHTC projects. The first example illustrates a typical suburban project with 9 percent LIHTCs. This project is expected to be similar in construction and quality to non-luxury market rate apartment complexes in the same locale. The second example illustrates a similar project to the suburban project in terms of location and cost, but is financed with tax-exempt bonds so that the project receives 4 percent LIHTCs. Moreover, the bond-financed project in the second example assumes that a third party contributes additional equity to cover the gap between project cost and the proceeds of the tax-exempt bond combined with the proceeds of sale of the LIHTC equity. The third example assumes an urban redevelopment project that is located in a high-cost area or qualified census tract that entitles the project to a 30 percent increase in eligible basis. In the third example, it is assumed that the project is financed in significant part by below-market soft debt provided by a governmental or community organization.

As previously discussed, an investor in an LIHTC project buys more than tax credits. In addition to tax credits there are the other investment components: (1) cash flow from operations, (2) distribution upon sale, and (3) tax losses and gains. As Table 1 shows, the present value of these components varies among the three paradigm investments. The result is that the financial model yields significantly different valuations for the three projects on a per equity dollar

investment. With respect to the 9 percent deal example, over 75 percent of the value of the project is attributable to the tax credits alone and 13 percent of the value is attributable to other tax benefits. In this example, relatively little of the project value is due to non-tax related, economic aspects of the project.

The mixed-use urban redevelopment bond project shows almost all of the benefits coming from tax attributes of the investment – 75 percent from the tax credits and 20 percent from other losses and deductions. Moreover, the first mortgage debt is quite small in relation to the total tax credit equity. This is in part due to the project being located within a difficult to develop area that entitles the project to a 30 percent increase in the amount of tax credits.

The bond deal example shows an investment in which it is primarily a real estate transaction and only secondarily a tax credit investment. Only about one-third of investment value is attributable to the value of the LIHTCs. The low level of tax credits is attributable to the fact that the applicable federal rate for tax credit purposes is only 3.45% and the applicable fraction of the project that generates tax credits is 40 percent. The bond tax credit investment would only be suitable for investors looking to make a real estate investment as well as a tax credit investment. While these types of investments are relatively uncommon, they do exist in certain markets, particularly in ones, such as New York City in which there is an extremely wide gap between the rents that can be generated by market rate units and the maximum rents permitted under the LIHTC program.

While the examples are merely illustrations, they do demonstrate how LIHTC investments can differ substantially in the components of yield and the applicable risk factors. The discounted cash flow analysis can provide insights into the investments characteristics that would be missed by using a single metric such as tax credit price.

The Last 10 Years

This article updates one that was published in the Summer 1996 edition of the ABA Journal of Affordable Housing.[27] The author was struck by the dramatic changes that have taken place in the industry since this original publication. Prices for tax credit deals have risen dramatically – from approximately $0.60 in 1996 to over $0.90 in 2005. Moreover, while the price per credit paid by an investor has increased by about 50 percent, the share of deal economics received by the investor has fallen sharply. In 1996, it was common for an LIHTC investor to receive half the cash flow from a transaction, plus half or more of the proceeds of a liquidation, while in the current market three-fourths or more of the economics goes to the LIHTC developer. In fact, tax considerations that require an economic interest in favor of the LIHTC investor seem to be the only factor preventing many deals from getting done with the investor having no material economic investment in the LIHTC project.

Why these changes? Part of the increase in tax credit price is attributable to a drop in interest rates and a decrease in yield of competing investments. A more important cause has been the increased efficiencies and competition in the market for LIHTC investments. The growth of the syndication industry has led to substantial competition for LIHTC projects. This trend has benefited the developers, which control tax credit projects, not only be lowering yields to the investors, but also by increasing the share of real estate benefits received by the developers. The drop in yields to investors is also attributable to a reduction in the perceived risk of LIHTC projects among investors. As to real estate exposure, the past 10 years has been generally strong in the real estate market and LIHTC projects have fared well. Moreover, investors are increasingly comfortable with the tax risk associated with LIHTC investments. The audit history for projects of the last 10 years has not been alarming to tax credit investors. Also,

the Internal Revenue Service has issued guidance on a wide range of issues, thus reducing investors tax concerns. Another factor adding froth to the market has been investments by banks seeking Community Reinvestment Act credit and other mission based investors, which are relatively price insensitive in choosing investments.

Over the last 10 years investor preferences have emerged for certain types of products. HOPE VI deals and other urban transactions with large allocations of 9 percent credits are particularly valued. As the debt service burden on these deals is usually quite low relative to the tax benefits, the investors favor these defensive investments. Bond deals using the 4% credits have become challenging to finance. The relatively small tax credit component in these transactions relative to debt and real estate risk has caused these transactions to be perceived as less attractive. As each of these examples show, the LIHTC industry tends to favor those deals that are more purely LIHTC investments rather than a more even blend between LIHTC benefits and real estate assets.

Conclusion

The LIHTC industry was created and has matured over the past 20 years since the enactment of the Tax Reform Act of 1986. In an increasingly mature industry, the tools of careful qualitative and quantitative analysis will be even more important to investor decision marking.

TABLE 1

ILLUSTRATION OF EQUITY EVALUATIONS FOR THREE TYPES OF LIHTC PROPERTIES

RESULTS

	Suburban 9% Deal		
	Allocation Per Equity $	**% of Total Value**	**Total $ Value**
Present Value of Tax Credits	$0.71	75.13	4,605,469
Present Value of Cash Flow	$0.02	2.37	145,097
Present Value of Sale at Year 15	$0.08	8.00	490,611
Present Value of Tax Attributes (other than tax credits and liquidation)	$0.12	13.05	800,228
Present Value of Tax Consequences of Liquidation	.01	1.44	88,569
Total	$0.95	100.00%	6,129,974
	Mixed Use Bond Deal		
	Allocation Per Equity $	**% of Total Value**	**Total $ Value**
Present Value of Tax Credits	$0.71	35.44%	953,991
Present Value of Cash Flow	$0.73	36.47	981,753
Present Value of Sale at Year 15	$1.65	81.89%	2,204,240
Present Value of Tax Attributes (other than tax credits and tax consequences of liquidation)	$0.59	29.48%	793,598
Present Value of Tax Consequences of Liquidation	<1.67>	<83.29>	<2,241,879>
Total	$2.01	100.00%	$1,692,565
	Urban Redevelopment Project with , Heavily Subsidized Deal		
	Allocation Per Equity $	**% of Total Value**	**Total $ Value**
Present Value of Tax Credits	$0.75	78.99%	$5,399,449
Present Value of Cash Flow	$0.01	0.71%	48,518
Present Value of Sale at Year 15	$0.01	0.72%	48,946
Present Value of Tax Attributes (other than tax credits and tax consequences of liquidation)	$0.14	14.32%	979,018
Present Value of Tax Consequences of Liquidation	$0.05	5.26%	359,770
Total	$0.95	100.00%	$6,835,791

ASSUMPTIONS

	Suburban 9% Deal	Mixed Use Bond Deal	Inner City Heavily Subsidized Deal
Total Project Cost	$10,000,000	$11,000,000	$12,400,000
Eligible Basis	$ 8,000,000	$ 9,800,000	$11,500,000
Applicable Percentage	8.05%	3.45%	8.05%
Applicable Fraction	100%	40%	60%
100% Area or 130% Bump Area	100%	100%	130%
Interest of Investor in Depreciation and Tax Credits	99.9%	99.9%	99.9%
Interest of Investor in Liquidated Proceeds	20%	80%	20%
Percentage Interest of Investor in Liquidation Proceeds	20%	80%	20%
Net Operating Income (stabilized year one)	374,580	$470,975	$256,534
Annual Growth in Net Operating Income	2.5%	3.5% (simulating higher expected growth rate from market rate units)	2.5%
Sell Project in Year 15, cap rate on sale of Project	9.0%	8.5%; lower cap rate to reflect remaining period of tax-exempt financing	7.0%; lower cap rate based on assumption of below market-rate financing
First Mortgage	$3,734,600; 7% fixed interest rate; 30-year fully amortized	$6,782,840; 5.0% fixed interest rate; 30-year fully amortized	$2,576,297; 7% fixed interest rate; 30-year fully amortized
Debt service coverage ratio on first mortgage	120%	120%	115%
Second Mortgage	None	$1,500,000; 0 interest rate; no payments prior to maturity	$3,000,000; 0% interest rate; payments due from 50% of net operating income after debt service expense on first mortgage
Discount rate for purposes of determining present value	11.1%	11.35%	10.3%

[1] U.S. Department of Housing and Urban Development, Office of Policy Development and Research, *Updating the Low-income Housing Tax Credit (LIHTC) Database Projects Placed in Service Through 2002* (December 2004)
[2] National Low Income Housing Coalition, *2005 Advocate's Guide to Housing and Community Development Policy*, http://www.nlihc.org/advocates/lihtc.htm.
[3] See U.S. Department of Housing and Urban Development, Office of Policy Development and Research, supra note 1.
[4] National Low Income Housing Coalition, supra note 2.
[5] Individual investors and closely held C corporations are subject to restrictions on the utilization of passive losses and LIHTCs that do not apply to widely held C corporations.
[6] *Developers Consider the Year Ahead*, Affordable Housing Finance, January 2006.
[7] I.R.C. § 42(f)(1) (1994).
[8] I.R.C. § 42(j).
[9] I.R.C. §§ 42(m)(1)(D), (2).
[10] Although LIHTCs are available for the renovation of existing improvements, they may be used for the cost of such improvements only if at least ten years have passed since the date of the last placement in service of the project or since the date of the last substantial improvements to the project. *See* I.R.C. § 42(d)(2)(B). The Treasury Department may grant waivers to the ten-year rule if the project is being acquired from HUD or a federally insured depository institution. I.R.C. § 42(d)(6).
[11] I.R.C. § 42(g)(2).
[12] I.R.C. § 42(g)(1).
[13] I.R.C. §§ 42(b)(1), (i)(2). A taxpayer who receives a federally subsidized loan can elect to exclude the loan from eligible basis as an alternative to having the project's applicable percentage reduced to the 4 percent level. I.R.C. § 42(i)(2)(B). Certain types of below-market federally funded loans are not treated as federal subsidies (e.g., loans funded with HOME program funds or community development block grants). I.R.C. § 42(i)(2)(D).
[14] Rev. Rul. 2006-07, 2006.
[15] I.R.C. § 42(c)(1).
[16] I.R.C. § 42(d).
[17] I.R.C. § 42(h)(6)(B).
[18] I.R.C. § 42(h)(6)(E)-(F).
[19] I.R.C. § 42(h)(5).
[20] See U.S. Department of Housing and Urban Development, Office of Policy Development and Research, supra note 1.
[21] Cf. St. David's Health Care System v. USA, 349 F.3rd 232 (5th Cir. 2003); Redlands v. Surgical Servs. v. Commissioner, 113 T.C. 47 (1999).
[22] Under I.R.C. § 42(i)(7), the grant of the right of first refusal is permitted, even though it terminates the applicable rent restrictions and tenant income limitations.
[23] *See generally* Wayne H. Hykan, *Plugging the Gap – The Role of Subordinate Financing in Low-Income Housing Tax Credit Transactions*, 34J. AFFORDABLE HOUS. & COMMUNITY DEV. L. (1994).
[24] I.R.C. § 42(d)(5)(C)(ii)-(iii) (1994).
[25] *See* I.R.C. § 42(h)(1)(E) regarding the requirements for a valid carryover allocation.
[26] *See* S.E. Cannon & K.M. Howe, *Reconciling Finance and Real Estate Valuation Methods*, 12 REAL ESTATE FINANCE 48 (1995). This article discusses the use of different types of discounted cash flow analysis in valuing real estate.
[27] Wayne H. Hykan, *Pricing the Equity of a Tax Credit Project: An Institutional Investor's Perspective,* 5 J. AFFORDABLE HOUS. & COMMUNITY DEV. L. 4 (1996).