BedfordLending

LIHTC & HUD Overview

The Low-Income Housing Tax Credit (LIHTC) program was enacted in 1986 and is run by the US Treasury Department and State Housing Authorities. LIHTC is the federal government's primary program for encouraging the investment of private equity in the development of affordable rental housing. Since its creation in 1986, LIHTC has helped finance more than 2.4 million affordable rental-housing units for low-income households.

HUD financing can be combined with LIHTC to:

- Cover 100% of cash required at closing, provide a Developer's Fee, and pay for HUD escrows required during construction (i.e. for operating deficits and construction contingencies).
- Qualify for streamlined HUD processing, which typically reduces processing time by up to 2 months.
- Removes limits on secondary financing.
- Secure reduced HUD processing fees.
- Secure higher leverage (including a smaller vacancy factor) in underwriting.

How does it work?

LIHTC (pronounced lie-tech) is an indirect federal subsidy. To promote affordable multifamily housing, the IRS allocates tax credits each year to state Housing Finance Authorities, and developers subsequently apply for an allocation of these credits for their project. For developers that do not have experience with this process, Bedford Lending will help.

Investors are eager to purchase tax credits, as they provide a substantial return on investment. See the following chart for a hypothetical transaction:

Project Budget/Total Cost	$10,000,000
Amount of LIHTC Credits allocated by State Housing Authority towards project	$3,240,000 (Credits are based on a percentage of total project cost)
Investor Purchase Price of Credits	**$2,754,000** (Estimated 85 cents per credit)

This $2,754,000 figure is the equity delivered to the project. Essentially the investor is contributing that money towards the project, but receiving the full $3,240,000 amount as a federal tax credit. In addition, the investor is allowed to recognize the project's real estate losses such as depreciation and interest expense, and *derives* income from these losses.

Structure

The investor and developer form a limited partnership as part of the LIHTC transaction. This structure allows tax credit benefits and real estate losses to pass through to investors. While having an ownership interest, the investor has no management authority, and the developer typically retains the majority of the cash flow.

Investors typically leave the partnership in years 11-16 because they no longer receive tax credits. At this point the general partner secures 100% ownership of the project.

The LIHTC is a win-win-win, as the developer receives equity and a fee for completing the project, lower income households secure quality housing, and the investor receives a substantial return (in the form of credits) on their investment.

Rent Restrictions

Unlike *subsidized* properties that carry tenant vouchers or rental assistance contracts, LIHTC properties do not receive a direct government rental subsidy. A tenant's rent cannot exceed 30% *of* 60% of the area's median income, and rent is paid directly to the owner of the property. Bedford Lending can determine the available rents for each project as part of our preliminary due diligence.

Case Study – *New England Apartment Construction project*

An experienced developer approached Bedford Lending to assess the construction of a new market rate apartment project in New England using our 221(d)(4) Program. Rents in the market were reasonably strong, however they could not support current construction costs, and the deal required $7,600,452 in equity at closing which made the project unfeasible.

Bedford Lending completed a second finance analysis using our 221(d)(4) program with LIHTC. We used the same construction costs and projected expenses and lowered rents to comply with the LIHTC affordability requirements. Under the new structure the client did not have to bring in any equity, will receive a $1,216,000 Developer's fee and a sizable construction profit. The following chart compares the key metrics of the transaction:

	Market Rate	LIHTC
NOI	$ 1,253,359	$ 1,197,149
HUD Mortgage Amount	$ 18,083,000	$ 18,626,973
Equity Required at Closing	$ 7,600,452	None
LIHTC Equity	None	$ 8,567,503
Developer's Fee	None	$ 1,216,000
Cash Flow	$ 188,007	$ 155,684
Cushion*	None	$ 1,221,935

*The cushion is the amount a project's construction cost could increase (or LIHTC equity decrease) without impacting the Developer's Fee.

Program Notes

- The Developer’s Fee allowed with HUD is set by the State Housing Authority allocating the LIHTC credits and is typically $8,000-$12,000 per unit.
- Investors like to work with developers who have a positive LIHTC track record. For developers that have not previously worked with LIHTC or other affordable housing, Bedford Lending can secure partners to help facilitate the transaction.
- If the project site is in particularly difficult economic areas (Bedford Lending can determine), the developer qualifies for an even greater amount of LIHTC equity.
- The ownership structure of a LIHTC property is typically a partnership, with the developer considered the General Partner, and the investor the Limited Partner.
- The project must remain affordable for at least 30 years, however the LIHTC investor receives all their tax benefits over the first 10 years, and generally leaves the partnership between year 11-16.

Conclusion

In addition to the debt provided with our direct HUD loans, Bedford Lending facilitates the entire bond transaction for our clients at no additional fee. Bedford Lending is the principal contact and coordinates with all parties to ensure an efficient process. BLC has been a direct HUD lender for 25 years and our principals average 30 years’ commercial finance experience.

Please contact us today to learn more.