



# ***San Diego Housing Federation***

**In Plain English:  
Finance Affordable  
Housing**





# ***Panelists***

- ✧ **Ramon Mendez Jr.**
  - California Housing Partnership Corporation
- ✧ **Andrea Ursillo**
  - Citibank
- ✧ **Carlos C. de Baca**
  - San Diego Housing Commission
- ✧ **Evan Becker**
  - RedCapital



# ***Financing Affordable Housing***

- ✧ **Financial Feasibility**
- ✧ **Two Typical Financing Models**
- ✧ **Types of Financing**
  - Hard and Soft Debt vs. Equity



# ***What is Financial Feasibility?***

✧ **Answering yes to these three questions:**

- Is there enough income to pay expenses, debt service, and reserves?
- Over 15 years, is there enough income to pay expenses, debt service, and reserves?
- Are there enough funding sources to pay development costs?



# ***Financing Affordable Housing***

## **✧ Two Typical Financing Models**

- Taxable Debt with 9% Tax Credits
- Tax-Exempt Debt with 4% Tax Credits



# ***Taxable Debt & 9% Tax Credit Model***

- ✧ **Bank loan (“taxable” also considered standard bank loans)**
- ✧ **Public agency loans**
  - State, County, City loans
  - Can include one or more of the list above
- ✧ **9% Tax Credits (competitive)**



# ***Tax-Exempt Debt & 4% Tax Credit Model***

## **✧ Tax-Exempt Bond Bank loan**

- Must compete for an allocation of tax-exempt bonds from California Debt Limit Allocation Committee (CDLAC)

## **✧ Public agency loans**

- State, County, City loans
- Can include one or more of the list above

## **✧ 4% Tax Credits (non-competitive)**

# ***BANK LOANS (cont)***

- ✧ **Bank Loans are HARD DEBT**
- ✧ **Bank Loans can be taxable or tax-exempt**
  - Taxable loans are the typical loans one can get from a bank
    - Taxable loans are paired with 9% tax credits
  - Tax-exempt bond loans were created in the 1986 Tax Reform Act
    - Have lower interest rate than taxable loans because bond purchasers are exempt from paying federal tax on the interest earned
    - Tax-exempt bond loans are paired with 4% tax credits



# ***PUBLIC AGENCY LOANS***

- ✧ **Public agency loans are SOFT DEBT**
- ✧ **Borrowed money that must be repaid at the end of the typical 55 year term**
- ✧ **Public agency lenders have a subordinate claim below hard debt lenders**
- ✧ **Soft debt lenders receive simple interest (0% - 5%)**
- ✧ **Loans are structured as residual receipts**
  - A loan with annual payments as cash is available, from some percentage or all of residual receipts, defined as cash remaining after payment of expenses, debt service and reserves.

# ***PUBLIC AGENCY LOANS***

***(cont)***

- ✧ **The source of public agency loans can from:**
- ✧ **Federal (but allocated to State and local agencies):**
  - HOME
  - Community Development Block Grant (CDBG)
- ✧ **State:**
  - Multifamily Housing Program (MHP)
  - Joe Serna Jr. Farmworker Housing Grant Program
- ✧ **Local:**
  - Redevelopment Agency
  - Housing Trust Fund



# ***LOW INCOME HOUSING TAX CREDITS***

- ✧ **The 1986 Tax Reform Act created a tax incentive for the development of affordable rental housing**
- ✧ **Tax Credits provides a dollar-for-dollar credit against taxes due from owners of newly constructed or rehabilitated low- income housing**
- ✧ **Equity is not debt because it is not repaid**



# ***LOW INCOME HOUSING TAX CREDITS***

- ✧ **The IRS apportions tax credits to each State's agency**
  - California Tax Credit Allocation Agency (TCAC)
- ✧ **Competitive 9% tax credits are allocated by the IRS to each state on a per capita basis**
  - In CA for 2007, that represents about \$71 million in annual “competitive” credits
- ✧ **“Non-competitive” 4% tax credits are unlimited**



# ***LOW INCOME HOUSING TAX CREDITS (cont)***

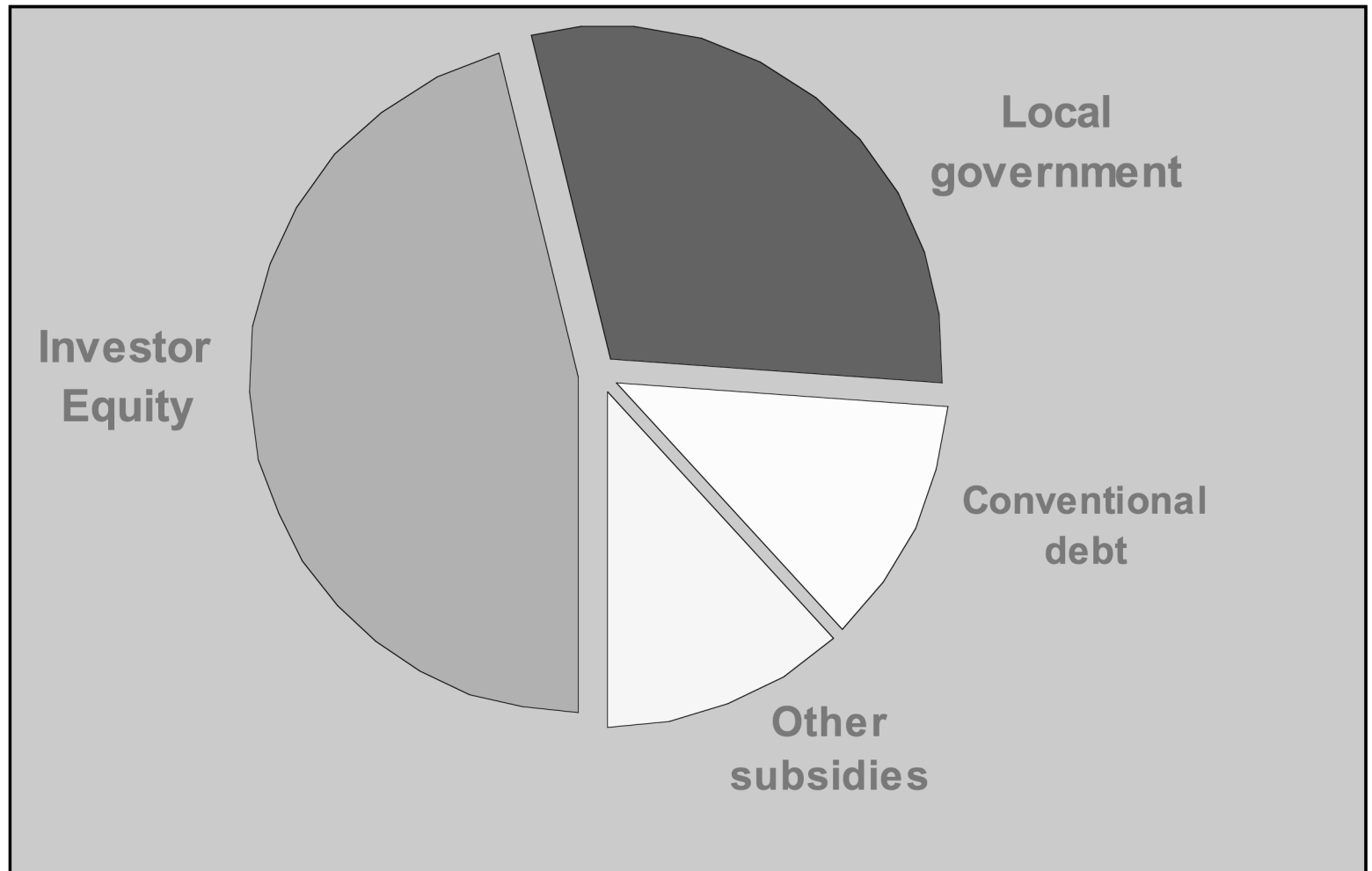
- ✧ **Developers apply to TCAC for an allocation of tax credits, then “sell” them to investors as annual credits that offset their federal taxes otherwise owed.**
- ✧ **Funds received from the sale of tax credits becomes tax credit equity to develop affordable housing**
- ✧ **Generally, tax credits are delivered over the first 10-11 years of operation; however, there is a total 15 year compliance period**



# ***LOW INCOME HOUSING TAX CREDITS (cont)***

- ✧ **A limited partnership is the owner of the project. It is the mechanism in which the the tax credits are delivered to the investor (Limited Partner)**
  - Managing General Partner owns 1%
  - Limited Partner owns 99%
- ✧ **The Limited Partner exits after the 15 year compliance period**

# ***Generic Financing Model***





# **COMPARING 9% & 4% MODELS**

## **✧ 9% - Competitive**

- Compete through TCAC (highly competitive)
- State allocations based on per capita formula
- Generates large amounts of credits & equity
- Reduced by certain federal subsidies

## **✧ 4% - Non-Competitive**

- Requires allocation of tax-exempt bonds from CA Debt Limit Allocation Committee (CDLAC)
- Available from TCAC w/o competing (subject to meeting threshold requirements)
- No state volume cap on credits
- Generates lower credits & equity
- Not reduced by federal subsidies

# **Sample Project**

| <b>Source</b>                 | <b>9% Scenario</b> | <b>4% Scenario</b> |
|-------------------------------|--------------------|--------------------|
| <b>Citibank</b>               | <b>2,800,000</b>   | <b>2,200,000</b>   |
| <b>State MHP</b>              | <b>-</b>           | <b>3,500,000</b>   |
| <b>Public Agency</b>          | <b>2,500,000</b>   | <b>2,500,000</b>   |
| <b>Deferred Developer fee</b> | <b>0</b>           | <b>800,000</b>     |
| <b>Investor Equity</b>        | <b>10,000,000</b>  | <b>6,500,000</b>   |
| <b>TOTAL</b>                  | <b>15,300,000</b>  | <b>15,500,000</b>  |

## **The Investor's View of the LIHTC Transaction**

### **□ Development Team**

- Experience/track record (Is there a history of success? Is it matched with the type of project?)
- Developer capacity (Are there adequate staff and financial resources- relative to workload?)
- Contractor (Experienced? Bondable?)
- Asset/property management (Who manages for the long term?)

### **□ Real Estate**

- Rent compared to market (Is there “market risk”?)
- Lease up (Can we fill the project? At what rate?)
- Competitive product (What is the competition?)

### **□ Financial Structure**

- Basic underwriting
  - Sources and uses (Can the project get built?)
  - Revenue and expense (Rents achievable? Good assumptions about vacancies? Expenses realistic? Can the project operate above “breakeven”?)
  - Debt financing (Can the project support its debt?)
  - Reserves (Is there an adequate “backstop”?)
  - Guarantees (Who ultimately stands behind the project? What resources and commitment do they have?)
  - Stress (The “What if”? scenarios)
- “Special” Issues
  - Tax issues (It is a “tax” related program, and there can be tax issues!)
  - Environmental (Increasingly difficult to find “clean” sites)
  - Timing issues (It is a program of deadlines and severe penalties!)

- **Investor Return and the Pricing of Tax Credits**
  - Amount and timing of the tax credits
  - Other benefits
  - Timing of the investor's contribution
  - "Yield" determined by the market