



**2008 HOUSING TAX CREDIT PROGRAM INFORMATION GUIDE**

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## PURPOSE OF THIS GUIDE

This guide was created by the Texas Department of Housing and Community Affairs (the “Department”) to provide an overview of the Housing Tax Credit Program (the “tax credit program”). The guide briefly explains the program’s rules, requirements and procedures, and the program’s benefits to tenants, developers and investors. Although this guide cites the Internal Revenue Code (the “IRC” or “Code”) as a part of the information presented, the Department does not and will not provide opinions about the meaning of the Code or statements that may be taken as guidance from the Internal Revenue Service (the “Service” or “IRS”). Opinions or interpretations of the Code, whether general or relating to particular real estate transactions may only be obtained from qualified sources such as certified public accountants, tax attorneys, consultants who specialize in the tax credit program, decisions resulting from legal proceedings or the Service, itself.

## OVERVIEW OF THE HOUSING TAX CREDIT PROGRAM

The tax credit program was created by the United States Congress to be administered by the principal state housing agency of each state on behalf of the Internal Revenue Service. Housing Tax Credits are called “low income housing tax credits” in the Internal Revenue Code. By restricting the rents that may be charged for rental units built or rehabilitated using tax credits, the credits benefit individuals and families who qualify to be tenants. Qualification is based on income. Rent restrictions may call for some units to have rents appropriate for tenants with incomes at 60% or 50% of area median gross income. The restrictions may be even lower if the applicant chooses, but in general, qualified tenants typically have incomes that are at or below 60% of the median gross income in the county where the tax credit development is located.

Developers apply to the state housing agencies for tax credits to profit from the construction of rental units. The developers obtain cash for construction by partnering with large financial institutions that create investment funds of tax credits in which investors can buy shares entitling them to use the credits in “payment” of federal income taxes. As an example of how developments are financed by the credits, consider that a developer awarded tax credits by the state might take a payment of 80 cents per dollar of tax credit from the partner financial institution. The institution (syndicator) would establish a tax credit fund for investors, taking a fee for establishing and managing the fund. The credits that cost 80 cents (plus the fee to the syndicator) per dollar of credit would be used by the investor to reduce federal income taxes dollar for dollar. Thus, all participants would profit from the development. Details of the brief outline just stated are given in the remainder of this guide.

## DESCRIPTION OF THE HOUSING TAX CREDIT PROGRAM AND HOW IT WORKS

**Statutes, regulations and rules.** The tax credit program was created by the Tax Reform Act of 1986. Funds were first available to the real estate development community in 1987. Section 42 of the Internal Revenue Code, as amended, is the federal law that governs the program, but the program is administered in each state by a state housing agency. The Code, Treasury Regulations and IRS Revenue Rulings state the federal rules to be followed by the state agencies, development owners and investor/taxpayers. However, in each state, the applicable state housing agency creates a “qualified allocation plan and rules” (“QAP”) describing the process of applying for tax credits, persons and types of rental property that are eligible and rules for constructing and operating developments financed by tax credits. Federal law permits the QAP to be more, but not less, stringent than the federal rules. The Texas QAP is more stringent than the federal rules.

**Availability of development financing from tax credits in Texas.** The tax credit program provides hundreds of millions of dollars per year to Texas for the development of affordable housing. The program is exclusively for rental housing. Although some government and quasi-governmental organizations use program funds, the money is used overwhelmingly for developments that are designed, constructed and operated by the private sector, not by government. Tax credits are available from two sources; the “credit ceiling” based on the size of the state’s population; and in connection with the “volume cap” associated with tax-exempt bond issues in which the bonds finance at least 50% of the cost of land and buildings in the development. Bond financed developments apply under a non-competitive process, and tax credits are, generally, automatically available in conjunction with tax-exempt

bond financing. Applications associated with the credit ceiling must participate in the program via a competitive application round that only occurs once a year.

The credit amount per capita of the credit ceiling has increased over the last several years, but currently each state is allocated \$1.95 per person in the state population. Under the credit ceiling, about \$458 million in tax credits will be allocated to Texas developers in 2007. In association with the volume cap on tax-exempt bond issues, about \$200 million in tax credits will be issued in Texas.

**Applying for tax credits.** One function of the QAP is to define an application procedure that, in effect, results in an annual contest among applicants for the state's tax credits under the credit ceiling. If the applicant for tax credits is successful in competing with the other applicants, he (an applicant may be a natural person or an organization) will receive a commitment from the housing agency for not more than the amount of credits necessary to build, or acquire and rehabilitate, a development whose operation will be financially feasible. Underwriters in the state agency estimate the amount of credits needed for financial feasibility and the amount of conventional and other types of financing that the development can support. The tax credit program is profitable for applicants and investors because an applicant that is successful in the "contest" "sells" the credits at a discount to investors who then use the credits at face value to pay federal income taxes.

**The way tax credits are used.** Since the inception of the tax credit program, the system of financing developments with tax credits has become well organized. The ownership of a tax credit development is almost always vested in a limited partnership. Limited partnerships are comprised of a general partner and one or more limited partners. The general partner is responsible to the limited partners for the day to day operations of the partnership's business and legally liable for the consequences of those operations. The limited partners are the investors in the partnership's business. The limited partners may not interfere in the operation of the business except to remove and replace the general partner. Both the general partner and limited partner may be individuals (natural persons) or business organizations.

Prior to closing a construction loan and initiating construction, the successful applicant is typically both the general partner and the limited partner in the development owner. At the time of finalizing negotiations for a construction loan, the applicant will generally finalize negotiations with one of many large national financial institutions, and the institution will take over the limited partner interest. Most commonly, the limited partner of the limited partnership that owns the tax credit property will be another limited partnership. The general partner of this secondary limited partnership is typically the national financial corporation or institution that, among other business interests, specializes in the "syndication" of tax credit investments. In essence, the syndicator buys the credits, packages the credits into investment funds and sells shares in the funds to large individual, corporate and institutional investors. The creation of tax credit investment funds that are managed by large institutions enables the existence of a secondary market for tax credits, and shares in the funds may be bought and sold by investors. The syndicator, as general partner of the entity that is the limited partner of the development owner, must watch over the general partner of the development owner to assure that all of the rules of the Code and QAP are followed. Failure to construct and operate the rental property in compliance with the rules may invalidate some or all of the credits, causing losses to investors and to the syndicator.

**Amount of tax credits a development can obtain – GAP and Eligible Basis.** Under the Code and the QAP, development proposals must be underwritten so that no development is allocated more credits than necessary to make the development financially feasible. The amount of credits allocated must be the lower of two calculations, the eligible basis method calculation and the "gap" calculation. The **gap** calculation is quite simple. The financing necessary to fill the gap between total development cost and financing available from all sources other than tax credits (excluding owner's equity) is, basically, the answer provided by the gap calculation. The dollar amount available through syndicating the credit establishes the amount of credits necessary to fill the gap. The cents on the dollar that a syndicator will pay for credits associated with a particular development is derived from commitment letters or letters of interest from syndication firms.

The **eligible basis** calculation is more complex. If a prospective developer submits a successful tax credit application, the tax credits that the proposed development is eligible to receive typically are determined by the eligible basis calculation. In the eligible basis method, the credits are calculated based on the amount of qualified development costs that are incurred in acquiring and constructing the development. These qualified development costs are called “eligible basis.” In general, development costs are eligible basis if the costs are associated with depreciable improvements that are constructed or installed in the process of building new rental units and associated improvements or rehabilitating an existing rental property. The cost of the existing improvements in a property acquired for rehabilitation are also eligible basis.

The amount of the credits calculated based on the eligible basis may be affected by the location of the development, and the amount will be affected by the percentage of units in the development that are tax credit units instead of market rate units (the “applicable fraction”) and the “applicable federal rate” (also called the “applicable percentage”) that has been calculated and published by the Treasury Department for the month in which the tax credit buildings are placed in service. Developments built in locations that have been designated by HUD as “Difficult Development Areas” (DDAs) or “Qualified Census Tracts” (QCTs) are eligible for a 30% increase in the eligible basis upon which the tax credits are calculated. After any applicable adjustment for location in a QCT or DDA is applied, the percentage of affordable (tax credit) units within the development or the percentage of total rentable square feet devoted to tax credit units, whichever is less, is used to multiply the adjusted eligible basis (at this point the “eligible basis” has become the “adjusted basis” in tax credit jargon) to arrive at the “qualified basis”. Finally, the qualified basis is multiplied by the “applicable federal rate”, also called the “applicable percentage” to arrive at the tax credits that the development may receive.

The applicable federal rate or applicable percentage is an important part of calculating tax credits because it can, to some extent, be controlled by the applicant. Two applicable federal rates are published monthly by the Treasury Department. The lower of the two rates is often called the 4% rate (and also called the 30% rate) and has historically varied from about 3% to just less than 4%. The higher of the two rates is often called the 9% rate (and also called the 70% rate) and has varied just below 8% to just below 9%. The 4% rate must always be used as the multiplier of the qualified basis if the qualified basis originated from the cost of existing improvements acquired for rehabilitation (often called acquisition basis). For rehabilitation or new construction expenditures that will be partially financed by federal grants or below market rate loans (financing that qualifies as “federal funds”), the applicant may either use the 4% rate or subtract the federal funds from the qualified basis before multiplying by the applicable federal rate (applicable percentage).

In addition to the options above, the applicable percentage may be controlled by another method. The percentage may be irrevocably “locked-in” soon after an applicant is chosen for an award of tax credits. Locking-in the rate is accomplished in conjunction with either of two types of agreements, depending on whether the award of tax credits resulted from an application in the competitive allocation round or in connection with a development receiving tax-exempt bond financing. In the former case, a “carryover allocation agreement” committing the applicant to place the proposed development in service within two years of the award of tax credits contains a checkbox to signify that the applicant is locking-in the rate as the rate effective in the month that the applicant and the Department sign the agreement. In the case of tax-exempt bond issues, an “election statement” may be signed by the applicant locking the rate as the rate effective in the month that the tax-exempt bonds are issued. If not locked-in, the applicable percentage for both applicants in the competitive round or “bond” applicants will be the percentage in effect in the month in which the improvements are placed in service (ready for occupancy).

**Expertise is needed to participate in the tax credit program.** As the foregoing discussion indicates, a substantial amount of expertise is necessary to structure the financing and other aspects of a tax credit development so that the development produced and the return on capital to investors is optimized. The Department does not advise applicants about the optimal or most effective strategies for obtaining and using tax credits. Before applying, applicants should always have consulted a professional tax advisor who has substantial expertise that is specific to the tax credit program. Specific expertise is necessary to determine optimal financing strategies and which costs of application and development can be claimed as eligible basis. Besides housing tax credits, the financing of a development might

include grants or loans from the federal HOME program, federal Community Development Block Grant (CDBG) funds for constructing infrastructure, and other federally subsidized below market rate loans. All of the types of funds just named complicate the issue of structuring the financing of a tax credit development.

### **MORE ABOUT HOW TAX CREDITS ARE USED BY DEVELOPMENT OWNERS**

Under the Code, tax credits may be used as dollar-for-dollar payment of federal income taxes. Only the owners of a Housing Tax Credit development may use credits. A credit is subtracted after the amount of tax is calculated. In this form, a credit differs from a deduction or adjustment. The use of tax credits is limited by the application of the passive loss provisions and other restrictions that exist in the Code. Some types of corporations may be able to utilize an unlimited amount of tax credits to offset their federal tax liability. Because an individual real estate owner typically can not use all of the tax credits he or she may obtain on a development against his or her own tax liability, the tax credits awarded to a low income development will usually not be useful unless outside investors acquire ownership interests in the development. As explained above, the term “syndication” is used to describe the process of structuring the financial arrangements and securing the investors who will join in a partnership and own the development.

Through a syndication, a limited partnership is created whereby the limited partners exchange initial equity for the benefits of the tax credits and possibly residual cash flow from the operation of the development over time. The syndications may be created by using either individual taxpayers as the limited partners or obtaining equity capital from a single corporate sponsor

### **WHAT PROPERTIES QUALIFY FOR TAX CREDITS?**

To be considered for tax credits, the proposed property must undergo new construction, rehabilitation or acquisition and rehabilitation. The minimum requirements necessary to qualify any building for rehabilitation under the tax credit program as referenced in Section 42(e)(3) of the Code are:

1. the expenditures are allocable to one or more low income units or substantially benefit such units; and
2. the amount of such expenditures over any 24 month period must be the greater of either 10 percent of the adjusted basis of the building; **or** the qualified basis, when divided by the number of low income units in the building, is, under the Code, \$3,000 or more. (Under the Texas QAP, the amount of direct hard cost incurred in the rehabilitation must be at least \$12,000 for each tax credit unit.)

Each development must include a minimum percentage of units to be set aside for eligible low income tenants. The rent charged on the units set aside must also be restricted.

Pursuant to Section 42(g)(1) of the Code, a qualified low income housing development means any development for residential rental occupancy if the development meets the requirement of **either**:

1. **20** percent or more of the residential units in such development are both rent restricted and occupied by individuals whose income is **50** percent or less of area median gross income<sup>1</sup>; **or**
2. **40** percent or more of the residential units in such development are both rent restricted and occupied by individuals whose income is **60** percent or less of area median gross income<sup>1</sup>.

It is important to note that once an election is made, it is irrevocable. Tax credits may only be claimed on the units that have been set aside for participation under this program. It is possible for development owners to set aside

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<sup>1</sup> This determination is made using the median gross income tables published annually by the U.S. Department of Housing and Urban Development.

100% of any development for consideration under the tax credit program and in doing so claim the maximum amount of tax credits eligible for the development. While 60% of area median income is the highest level at which a tenant may qualify for a tax credit unit, owners who choose the 20%/50% option above must restrict 100% of the tax credit units in the development to occupancy by tenants who qualify at 50% of area median income.

Tax credit units must be rent restricted. The Code citation that pertains to rent restrictions can be found in Section 42(g)(2). A residential unit is considered rent restricted if the gross rent does not exceed 30 percent of the imputed income limitation applicable to the unit. An example is given later in this guide.

### **CREDIT PERIOD, COMPLIANCE PERIOD, AND EXTENDED HOUSING COMMITMENT**

The following time periods apply to any development owner that utilizes tax credits under Section 42 of the Code:

**Credit Period** - With respect to a building within a Development, the period of ten taxable years beginning with the taxable year the building is placed in service or, at the election of the Development Owner, the succeeding taxable year, as more fully defined in the Code, §42(f)(1)

**Compliance Period** - With respect to a building, the period of 15 taxable years, beginning with the first taxable year of the Credit Period pursuant to the Code, §42(i)(1).

**Extended Low Income Housing Commitment** - No tax credits will be allocated to any building unless an extended low income housing commitment between the development owner and the housing credit agency is in effect. The requirements that must be met by this commitment are set forth in Section 42(h)(6) of the Code. The period that is to be covered by the extended low income housing commitment in the State of Texas is at least 15 years from the close of the compliance period (Section 42(h)(6)(D) of the Code). Therefore, the development will be required to maintain its affordable housing characteristics for a period of 30 years. There are however two provisions for the early release of the extended low income housing commitment:

1. Pursuant to Section 42(h)(6)(E)(i)(I) of the Code, the extended low income housing commitment shall terminate on the date the development is acquired by foreclosure (or instrument in lieu of foreclosure) unless the Secretary of the Treasury determines that such acquisition is part of an arrangement with the taxpayer a purpose of which is to terminate the extended use period. However, under the preceding provision, the development owner may not evict or terminate the tenancy (other than for good cause) of an existing tenant of any low income unit, or increase the gross rent with respect to such unit that is not otherwise permitted under the tax credit program, for a period of not less than three years. The citation that establishes this requirement may be found in Section 42(h)(6)(E)(ii) of the Code; and
2. Pursuant to Section 42(h)(6)(E)(i)(II) of the Code, if at the close of the 14th year of the compliance period the development owner provides the Department with a written request to find a purchaser to acquire its interest in the low income portion of the building. The Department will then be given a period of one year to find such a purchaser and offer the property at a pre-determined purchase price. If no such purchaser comes forward to acquire the low income portion of the property by the end of the one year period, then the extended low income housing commitment will be released. The specific Code references pertaining to this process may be found in Sections 42(h)(6)(F), (G), (H), and (I).

### **HOW TO REQUEST TAX CREDITS?**

The Texas Department of Housing and Community Affairs is the only entity in the State of Texas that has the authority to allocate tax credits under the Housing Tax Credit Program. Applications and all information necessary to apply are available throughout the year on the home page of the HTC Program on the TDHCA website. Applications must be completed on behalf of a proposed development owner and submitted to the Department for consideration within the time limits applicable to the particular year's Application Cycle as posted on the website.

Applications must be presented to the Department in conformity with the Housing Tax Credit Qualified Allocation Plan and Rules (the "QAP") during a published application acceptance cycle. All application cycles will be published in the Texas Register. Information about the cycles is also available by contacting the staff of the Multifamily Finance Production Division at any time.

To be considered for tax credits, developments must conform to the requirements of Section 42 of the Code. If an application is submitted for a development that does not meet the requirements of Section 42 of the Code, the Department will reject the application.

The Department has produced an Application Submission Procedures Manual that contains the necessary information and instructions for filing a tax credit application. The procedures outlined within the Application Submission Procedures Manual must be followed exactly as stated for the application to be considered.

As required by §2306.111 of the Texas Government Code, the Department will use a regional allocation formula to distribute credits from the State Housing Credit Ceiling. This formula establishes targeted tax credit amounts for each of the thirteen state service regions and is discussed in §50.7(a) of the 2008 QAP. The Department also utilizes set-aside categories for the allocation of tax credits. The actual set-aside categories and percentages associated with each are discussed in §50.7(b) of the QAP. Applications will compete against those other applications within their own set-aside category and/or state service region, as opposed to competing against all applications submitted.

When filing an application, the development owner must submit to the Department certain required documentation. These required documents are provided for within §50.9(f) of the QAP. All of the threshold items specified in §50.9(h) are *mandatory requirements* that must be provided at the time of application submission for an application to receive consideration.

§50.9(i) of the QAP establishes the selection criteria, which establish the various policy initiatives set forth by the Department under the tax credit program. The selection criteria are a series of questions concerning development location, housing needs characteristics, development characteristics, sponsor characteristics, participation of local tax-exempt organizations, tenant populations with special housing needs, and public housing waiting lists. Additional documentation may be required on certain selection criteria. Maximum scores for each selection criteria are also incorporated into the rules under §50.9(i). The Department makes no assumptions concerning the eligibility of a property to receive points for certain selection criteria items for which the applicant did not initially claim the eligible score.

### **TAX-EXEMPT BOND FINANCED DEVELOPMENTS**

Applications for developments which receive at least 50% of their financing from the proceeds of tax-exempt bonds which are subject to the state volume cap as described in the Code, §42(h)(4)(B) are also subject to evaluation under the QAP and Rules. Such developments must meet all the threshold requirements stipulated in the most recently approved QAP and Rules. Such developments must also demonstrate consistency with the bond issuer's local Consolidated Plan. If the Department determines that all requirements have been met, the Board, shall authorize the Department to issue an appropriate notice to the sponsor that the development satisfies the requirements of the QAP and Rules in accordance with §42(m)(1)(D).

### **CALCULATION OF THE TAX CREDIT AMOUNT AND THE MAXIMUM ALLOWABLE RENTS**

Probably the most common mistake in filing an application is the calculation of the maximum tax credit amount or the maximum monthly rental rate. In an attempt to minimize the number of incorrect allocation requests, an example of actual application pages and [sample](#) HUD median income information are provided to demonstrate the method of calculating both tax credit and monthly rental amounts.

In conjunction with determining a development's maximum eligible tax credit amount, the Department will review the feasibility of the proposed property and its potential to remain a viable low income housing development

throughout the compliance period. These issues also enter into the Department's final decision concerning the prospects of allocating tax credits to any development.

In determining the maximum amount of tax credits that a development may receive, the Department will utilize three basic methods of calculation. The first method considers the total qualified basis attributable to the property. Qualified basis is the amount of depreciable capital improvements to be made to the property during the development process multiplied by the applicable fraction which is equal to the lesser of the percentage of units set aside for occupancy by low income tenants under this program or the percentage of floor space attributable to the low income set aside units. A more in depth discussion pertaining to the applicable fraction will be provided later in this guide.

It is important that applicants who do not wish to set aside 100 percent of their available units for occupancy by low income tenants observe the applicable fraction requirement, as this factor must be adhered to in determining the maximum tax credit amount.

The second method of determining a development's maximum eligible tax credit amount is commonly referred to as the Equity/Funding Gap Method. Under this method, the Department analyzes the total development costs associated with the creation or rehabilitation of the development. The Department will then analyze the total sources of funding (development financing) to be obtained to meet these development costs. The resulting difference between the cost of development and available development financing is the Equity/Funding Gap. After the Equity/Funding Gap has been determined, the Department will then calculate the amount of tax credits necessary to satisfy this gap during the credit period.

The third method of determining the annual allocation amount is to utilize the requested amount submitted by the applicant. Through the utilization of these three methods, the Department attempts to maximize the issuance of the total tax credit authority available. The lesser of the annual allocation amounts derived from the three methods of calculation is utilized by the Department.

### QUALIFIED BASIS DETERMINATION

#### EXAMPLE 1. CALCULATION OF CREDITS FOR A "STANDARD" DEVELOPMENT

The development cost schedule shown in Figure 1.1 represents a "standard" development whose eligible basis amount will not be adjusted for such items as inclusion of market income units, site location, and use of below market rate federal loans.

Those sections of the development cost schedule shown in Figure 1.1 that are shaded means that qualified basis may not be claimed for that particular cost category under either the acquisition or new construction/rehabilitation components. Please note that the figures provided in Figure 1 represent a simplified example. **Typically not all of the development cost for each line is includable in eligible basis because some of the work may have been associated with noneligible activities.**

Figure 1.1\*

Category	Total Development Costs	Eligible Basis	
		Acquisition	Rehab./New Construction
<b>(1) ACQUISITION</b>			
Site acquisition cost	\$ 250,000		
Existing building acquisition cost	\$ 100,000	100,000	
<b>(2) Sitework</b>			
On-Site work	\$ 875,000	\$ 0	\$ 875,000
Off-Site improvements	\$ 0		
<b>(3) Construction Hard Costs</b>			
New structures	\$ 0	\$ 0	\$ 0

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Category	Total Development Costs	Eligible Basis	
		Acquisition	Rehab./New Construction
Rehabilitation hard costs	\$ 4,375,000	\$ 0	\$ 4,375,000
Accessory structures	\$ 0	\$ 0	\$ 0
<b>(4) Contractor Fees &amp; General Requirements<sup>2</sup></b>			
General requirements (6% max limit)	\$ 315,000	\$ 0	\$ 315,000
Contractor overhead (2% max limit)	\$ 105,000	\$ 0	\$ 105,000
Contractor profit (6% max limit)	\$ 315,000	\$ 0	\$ 315,000
<b>(5) Contingencies</b>			
Construction contingency	\$ 117,000	\$ 0	\$ 117,000
Rehabilitation contingency	\$ 0	\$ 0	\$ 0
<b>(6) Professional Fees</b>			
Architect, design	\$ 60,900	\$ 0	\$ 60,900
Architect, supervision	\$ 26,100	\$ 0	\$ 26,100
Real estate attorney	\$ 5,000	\$ 0	\$ 5,000
Engineer/survey	\$ 28,165	\$ 0	\$ 28,165
<b>(7) Interim Financing Fees and Cost</b>			
Hazard Insurance	\$ 7,500	\$ 0	\$ 7,500
Liability Insurance	\$ 7,500	\$ 0	\$ 7,500
Payment Bond	\$ 0		
Performance Bond	\$ 0	\$ 0	\$ 0
Credit report	\$ 0		
Construction loan interest	\$ 143,000	\$ 0	\$ 143,000
Origination fees	\$ 27,000	\$ 0	\$ 27,000
Bridge loan expense	\$ 0	\$ 0	\$ 0
Credit enhancement fees	\$ 0	\$ 0	\$ 0
Inspection fees	\$ 12,000	\$ 0	\$ 12,000
Title & recording	\$ 55,000	\$ 0	\$ 55,000
Legal fees	\$ 30,000	\$ 0	\$ 30,000
Real estate taxes	\$ 17,000	\$ 0	\$ 17,000

<sup>2</sup> General Requirements, Contractor Overhead and Contractor Profit eligible basis amounts cannot exceed 15% of the eligible basis associated with “On-Site Work” + “Construction Hard costs”.

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Category	Total Development Costs	Eligible Basis	
		Acquisition	Rehab./New Construction
<b>(8) Permanent Financing Costs</b>			
Bond premium	\$ 0		
Credit reports	\$ 0		
Discount points	\$ 0		
Origination fees	\$ 30,500		
Credit enhancement	\$ 0		
Title & recording	\$ 12,000		
Legal fees	\$ 24,000		
Prepaid MIP	\$ 0		
<b>(9) Soft Costs</b>			
Tax credit fees	\$ 36,700		
Consultant fees	\$ 0		
<b>(10) Other Development Costs</b>			
Market study	\$ 4,250	\$ 0	\$ 4,250
Environmental Study	\$ 2,300	\$ 0	\$ 2,300
Property appraisal	\$ 0	\$ 0	\$ 0
Other	\$ 0	\$ 0	\$ 0
<b>(11) Syndication Costs</b>			
Organizational	\$ 0		
Tax opinion	\$ 6,000		
<b>(12) Developer Fees</b>			
Developer overhead	\$ 96,776	\$ 0	\$ 96,776
Developer fee	\$ 885,981	\$ 15,000	\$ 870,981
<b>(13) Development Reserves</b>			
Rent up reserves	\$ 38,900		
Operating reserves	\$ 38,900		
Escrows	\$ 0		
<b>TOTAL DEVELOPMENT COSTS</b>	<b>\$ 8,047,472</b>	<b>\$ 115,000</b>	<b>\$ 7,419,472</b>
<b>Total Commercial Space Costs</b>	<b>\$ 0</b>		
<b>TOTAL RESIDENTIAL COSTS</b>	<b>\$ 8,047,472</b>	<b>\$ 115,000</b>	<b>\$ 7,419,472</b>

\*This table is a sample only, reflecting only general categories in a cost breakdown. It does not reflect all of the line items included in the required Cost Schedule.

Most of the cost items above are self-explanatory. Only several specific cost items will be discussed in greater detail below.

Category 1 (Acquisition) of the development cost schedule pertains to the cost to acquire the land and buildings that will comprise the affordable housing development. Due to the fact that tax credits are only eligible to be claimed on depreciable capital improvement, the cost of the land may not be included towards the qualified basis, and as such needs to be discounted from the total purchase price when determining qualified basis. The instances in which acquisition tax credits will be eligible to be claimed will be more thoroughly discussed during a later portion of this guide. The Department will require that the applicant supply either a current real estate tax valuation, clearly showing the percentage of total property value attributable to the land, or a purchase contract that clearly references the amount of the purchase price that is attributable to the land.

The syndication costs, as provided for in category 11 of the development cost section, relate to any and all expenditures associated with the syndication of the tax credits

Regarding developer fees in category 12, the Department will not allow the applicant to claim more than 15 percent of total eligible basis as a developers fee. When considering this amount, the total of both developer overhead and developer fee combine to represent developer fees. Consequently, the sum of these two line items when divided by total basis for both acquisition and rehabilitation/new construction, shall not exceed the maximum level. When an application represents both acquisition and rehabilitation, as the example depicts, and the applicant elects to claim a developers fee on both the acquisition of the buildings and their subsequent rehabilitation, then the applicant must claim the developers fees which would be allowable for both categories of costs, instead of placing all of the developers fees under the rehabilitation category. Eligibility of developers fees is discussed further in the underwriting guidelines later in this Information Guide. Developers fee may be earned on non-eligible basis activities (adjusted for the reduction of federal grants, B.M.R. loans, historic credits, etc.) not inclusive of the developer fees themselves, but only 15% of eligible basis items may be included in basis for the purpose of calculating developments credit amounts.

The total of each category of expenditure represents total residential costs associated with the development of the affordable housing property. Where applicable, the costs provided for within the development cost section of the uniform application should be consistent with the amounts specified within the development costs estimate submitted to the Department in accordance with the Uniform Application required under Section 50.9(e)(1) of the QAP.

Upon the completion of the cost items specified within the development cost section of the application form, the applicant will then deduct the following items from the total residential costs:

1. **All federal grant proceeds used to finance development costs** - Pursuant to Section 42(d)(5)(A) of the Code, any grant of which any portion is funded with Federal funds, will require that the eligible basis for that property be reduced by the amount of such grant. Simply stated this means that if a property receives a Federal grant then the amount of that grant must be subtracted from the total residential costs prior to the determination of tax credit amounts.
2. **Below market rate (B.M.R.) federal loans used to finance development costs** - Pursuant to Section 42(i)(2)(B) of the Code, those developments that are to receive financing, the source of which is from Federal funds, with an interest rate that is below the applicable federal rate, then the development owner must reduce the total residential costs by the amount of the principal of such financing. The alternative to this provision is for the development owner to reduce the applicable percentage from nine percent to four percent. A demonstration will be provided below for this scenario.
3. **Non-qualified non-recourse financing** - The provisions for this reduction are provided for within Section 42(k) of the Code pertaining to the At-Risk Rules. Generally speaking, non-qualified non-recourse financing is considered to be non-recourse seller financing. In the instance where a development owner acquires a property and as a portion of this acquisition price, the purchaser provides a note to the seller, the amount of such financing provided for within this note would be deducted from the total residential costs. This provision would not apply to RTC seller financing under their affordable housing disposition program.
4. **Non-qualified portion of higher quality unit** - Pursuant to Section 42(d)(3) of the Code, in the instance where there exists a disproportionate standard between the quality of the non-set aside low income units and those units set aside for affordable tenancy, the development owner must deduct the costs associated with those higher quality units away from the total residential costs.
5. **Historic Tax Credit** - In the instance where a property receives both historic tax credits and Housing Tax Credits, then the amount of the historic tax credits must be deducted from the rehabilitation portion of the total residential costs prior to the determination of the Housing Tax Credit amount.

Through the deduction of the above listed items, the applicant would reduce the total residential costs associated with the creation of the affordable housing and filter them into what is referred to as total eligible basis, which is covered in Section 42(d) of the Code.

To take the property from total eligible basis to total qualified basis, the applicant must apply the applicable fraction. The applicable fraction is defined in Section 42(c)(1)(B) of the Code as the smaller of either the unit fraction or floor space fraction as discussed below:

1. **Unit Fraction** - Pursuant to Section 42(c)(1)(C) of the Code, the unit fraction equals the amount of low income units divided by the total number of units (vacant or occupied) within the property.

$$\text{Low Income Units} \div \text{Total Units} = \text{Unit Fraction}$$

2. **Floor Space Fraction** - Pursuant to Section 42(c)(1)(D) of the Code, the floor space fraction equals the total floor space attributable to the low income units divided by the total floor space (whether or not occupied) of the property.

$$\text{Low Income Floor Space} \div \text{Total Floor Space} = \text{Floor Space Fraction}$$

By multiplying the total eligible basis as previously determined by the applicable fraction, the applicant will arrive at the total qualified basis of the property. To determine the maximum amount of tax credits that will be allowed under the qualified basis determination, the applicant will be required to multiply the total qualified basis by the applicable percentage.

For purposes of the initial analysis of the application under this program, the applicant should utilize four percent as the applicable percentage on allowable acquisition costs and new construction/rehabilitation costs that will utilize some form of below market rate federal subsidy, as provided for in Section 42(i)(2)(A) of the Code. For all other new construction/rehabilitation costs, the applicant will utilize nine percent as the applicable percentage.

At either the date on which the building is placed into service, as defined in IRS Advance Notice 88-116, or at the election of the development owner, the Department will fix the applicable percentage as in effect on either of the above two dates, pursuant to Section 42(b)(2) of the Code. The applicable percentage is set each month by the Secretary of the Treasury. A historical perspective of the movement of the applicable percentage from the inception of the tax credit program may be reviewed by the applicant in the reference manual.

As shown in Fig. 1.2 below, the development:

- does not have any funding sources that would require a reduction in the amount of “Total Eligible Basis.”
- is not located in an area that qualifies for the “High Cost Area Adjustment.”
- is comprised entirely of tax credit units so the applicable fraction is 100%.

**Figure 1.2**

<b>TOTAL DEVELOPMENT COSTS</b> (Carried forward from Fig. 1.1)	\$ 8,047,472	\$ 115,000	\$ 7,419,472
<b>(14) Deduct from Basis:</b>			
All federal grant proceeds used to finance costs in eligible basis		\$ 0	\$ 0
B.M.R. loans used to finance cost in eligible basis		\$ 0	\$ 0
Non-qualified non-recourse financing		\$ 0	\$ 0
Non-qualified portion of higher quality units [42(d)(3)]		\$ 0	\$ 0
Historic Credits (on residential portion only)		\$ 0	\$ 0
<b>TOTAL ELIGIBLE BASIS</b>		\$ 115,000	\$ 7,419,472
High Cost Area Adjustment (130% for QCTs and DDAs)			100 %
<b>TOTAL ADJUSTED BASIS</b>		\$ 115,000	\$ 7,419,472
Applicable Fraction		100 %	100 %
<b>TOTAL QUALIFIED BASIS</b>		\$ 115,000	\$ 7,419,472
Applicable Percentage		4.00%	9.00%
<b>TOTAL AMOUNT OF TAX CREDITS REQUESTED</b>		\$4,600	\$667,752

As can be seen in Fig. 1.2, the “Total Qualified Basis” amount has not been modified from the amount of eligible “Total Residential Costs” shown at the end of Fig. 1.1. The maximum annual amount of tax credits that may be claimed under the qualified basis determination would be \$672,352 (\$4,600 + \$667,752).

Utilizing the same total residential costs as provided in Fig. 1.1. the Department will now provide examples of how to determine the maximum amount of tax credits, through the qualified basis method, under a number of various scenarios.

**EXAMPLE 2. DEVELOPMENTS LOCATED IN EITHER A DIFFICULT DEVELOPMENT AREA (DDA) OR QUALIFIED CENSUS TRACT (QCT).**

Under certain circumstances, properties located in either difficult development areas or qualified census tract may be eligible to have their new construction/rehabilitation eligible basis increased by 130%, as provided for in Section 42(d)(5)(C) of the Code. The increase to eligible basis, for properties located in either a difficult development area or qualified census tract, is not allowable on any acquisition basis. The definition of these two areas are provided for below:

1. **Qualified Census Tract** - Pursuant to Section 42(d)(5)(C)(ii) of the Code, a qualified census tract is defined as any census tract that is designated by the Secretary of Housing and Urban Development (HUD) and, for the most recent year for which census data are available on household income in such tract, either in which 50 percent or more of the households have an income which is less than 60 percent of the area median gross income for such year or which has a poverty rate of at least 25%.
2. **Difficult Development Area** - Pursuant to Section 42(d)(5)(C)(iii) of the Code, a difficult development area is defined as any area designated by the Secretary of Housing and Urban Development as an area which has high construction, land, and utility costs relative to area median gross income.

The Secretary of Housing and Urban Development designates those areas that will receive the additional benefits inherent by increase the eligible basis. On an annual basis, the Department receives a listing of these qualified census tracts and difficult development areas and provides the information to you in the Reference Manual.

As shown in Fig. 2.1, the development:

- does not have any funding sources that would require a reduction in the amount of “Total Eligible Basis.”
- is located in an area that qualifies for the “High Cost Area Adjustment.”
- is comprised entirely of tax credit units so the applicable fraction remains is 100%.

**Figure 2.1**

<b>TOTAL ELIGIBLE BASIS</b> (Carried forward from Fig. 1.2)	\$ 115,000	\$ 7,419,472
High Cost Area Adjustment (130% for QCTs and DDAs)		130 %
<b>TOTAL ADJUSTED BASIS</b>	\$ 115,000	\$ 9,645,314
Applicable Fraction	100 %	100 %
<b>TOTAL QUALIFIED BASIS</b>	\$ 115,000	\$ 9,645,314
Applicable Percentage	4.00%	9.00%
<b>TOTAL AMOUNT OF TAX CREDITS REQUESTED</b>	\$4,600	\$868,078

In this example, the new adjusted eligible basis for the rehabilitation portion of the total residential costs has been increased from \$7,419,472 to \$ 9,645,314, which accounts for the 130% increase that increases the credit award by \$200,321.

**DEVELOPMENTS THAT RECEIVE FEDERAL SUBSIDY:**

Developments that will receive a form of below market mortgage financing which is funded in whole or in part through below market rate Federal funds will be required to reduce the credit percentage associated with the new construction/rehabilitation qualified basis or remove the funding source from eligible basis.

The most common occurrence that leads to this reduction is the use of financing from the Texas Rural Development Agency under its Section 515 program. This program provides long term mortgage financing at a subsidized interest rate of one percent. This type of property would fall under the requirement that its applicable percentage be reduced from nine percent to four percent.

As shown in Fig. 3.1, the development:

- has a federal below market rate loan of \$200,000 that the terms of would require a reduction in the amount of “Total Eligible Basis” or a reduction in the “Applicable Percentage.”
- is not located in an area that qualifies for the “High Cost Area Adjustment.”
- is comprised entirely of tax credit units so the applicable fraction is 100%.

**Figure 3.1**

<b>TOTAL ELIGIBLE BASIS</b> (Carried forward from Fig. 1.2)	\$ 115,000	\$ 7,419,472
High Cost Area Adjustment (130% for QCTs and DDAs)		100 %
<b>TOTAL ADJUSTED BASIS</b>	\$ 115,000	\$ 7,419,472
Applicable Fraction	100 %	100 %
<b>TOTAL QUALIFIED BASIS</b>	\$ 115,000	\$ 7,419,472
Applicable Percentage	4.00%	4.00%
<b>TOTAL AMOUNT OF TAX CREDITS REQUESTED</b>	\$4,600	\$296,779

In Figure 3.1, the applicable percentage was reduced from the initial nine percent to four percent, in accordance with Section 42(b)(2)(B) of the Code. The reduction in the applicable percentage decreased the tax credit amount on the rehabilitation from \$667,752 to \$296,779.

As an alternative, the applicant could have chosen to deduct the total principal amount of the federal below market interest rate financing from total residential costs, and in doing so, be permitted to utilize an applicable percentage of nine percent against the rehabilitation costs. The determination as to which method should be utilized is strictly up to the applicant. The Department will not be responsible for providing consultation concerning this decision to an applicant. This scenario is depicted in Figure 3.2.

**Figure 3.2**

<b>TOTAL DEVELOPMENT COSTS</b> (Carried forward from Fig. 1.2)	\$ 8,047,472	\$ 115,000	\$ 7,419,472
<b>(14) Deduct from Basis:</b>			
All federal grant proceeds used to finance costs in eligible basis		\$ 0	\$ 0
B.M.R. loans used to finance cost in eligible basis		\$ 0	\$ 200,000
Non-qualified non-recourse financing		\$ 0	\$ 0
Non-qualified portion of higher quality units [42(d)(3)]		\$ 0	\$ 0
Historic Credits (on residential portion only)		\$ 0	\$ 0
<b>TOTAL ELIGIBLE BASIS</b>		\$ 115,000	\$ 7,219,472
High Cost Area Adjustment (130% for QCTs and DDAs)			100 %
<b>TOTAL ADJUSTED BASIS</b>		\$ 115,000	\$ 7,219,472
Applicable Fraction		100 %	100 %
<b>TOTAL QUALIFIED BASIS</b>		\$ 115,000	\$ 7,219,472
Applicable Percentage		4.00%	9.00%
<b>TOTAL AMOUNT OF TAX CREDITS REQUESTED</b>		\$4,600	\$649,752

In Figure 3.2, the “Total Eligible Basis” amount was reduced by the \$200,000 loan. The reduction in the “Total Eligible Basis” resulted in the decreasing of the tax credit amount on the rehabilitation from \$667,752 to the current level of \$649,752.

It is important to note that some forms of Community Development Block Grant (CDBG) and HOME financing where the applicant clearly is required to repay the awarded funds are not considered under the provisions of a below market federal loan, as provided for in Section 42(i)(2)(D) and (E) of the Code respectively.

#### **EXAMPLE 4. DEVELOPMENTS THAT ELECT TO SET ASIDE LESS THAN 100% OF THE AVAILABLE UNITS.**

As stated previously, prior to calculating the qualified basis for any development, the development owner must first multiply the eligible basis by the applicable fraction. Under the four scenarios provided above, the development owner set-aside 100% of the available units for occupancy by persons or families of low and very low income.

For an example which describes the Applicable fraction for a mixed income development, the Department will assume the unit breakdown and square footage shown in Fig. 4.1.

**Figure 4.1**

# of Bedrms.	# of Units	Unit Size (Net Rentable Sq. Ft.)	Total Net Rentable Sq. Ft
<b>Tax Credit Units</b>			
1	17	700	11,900
2	25	900	22,500
3	8	1,100	8,800
	50		43,200
<b>Market Rate Units</b>			
1	8	700	5,600
2	25	900	22,500
3	17	1,100	18,700
	50		46,800
<b>Total Units</b>	<b>100</b>		<b>90,000</b>

To determine the applicable fraction, the applicant will need to perform both the unit fraction and floor space fraction calculations.

The formula for determining the unit fraction is:

$$\text{Low Income Units} \div \text{Total Units} = \text{Unit Fraction}$$

By utilizing this formula, the corresponding unit fraction for the unit composition and set-aside portions provided above would be 50% ( $50 \div 100 = 50\%$ ). The formula for determining the floor space fraction once again is:

$$\text{Low Income Floor Space} \div \text{Total Floor Space} = \text{Floor Space Fraction}$$

Consequently, the appropriate floor space fraction for the unit composition and set-aside portions as provided above would be 48% ( $43,200 \div 90,000 = 48\%$ ).

Upon the completion of these two calculations, the applicant would utilize the lesser of the unit fraction or floor space fraction. In the case of this example, the applicable fraction would be 48%. The applicant must use the applicable fraction against both the acquisition and new construction/rehabilitation categories to properly calculate the maximum allowable tax credit amount. Only that portion of the development that is set-aside for usage under this program may receive the benefits of the tax credits. Consequently, since the applicant in this example chose to set-aside only 48% of the property for tenancy by low and very low income persons and families, they may only be allocated that amount of tax credits that corresponds to the elected set-aside. As a result of this reduction in the applicable fraction, the qualified basis was reduced which leads to the reduction in the amount of tax credits that the development owner could claim.

**Figure 4.2**

<b>TOTAL ADJUSTED BASIS</b> (Carried forward from Fig. 1.1)	\$ 115,000	\$ 7,419,472
Applicable Fraction	48%	48%
<b>TOTAL QUALIFIED BASIS</b>	\$55,200	\$3,561,347
Applicable Percentage	4.00%	9.00%
<b>TOTAL AMOUNT OF TAX CREDITS REQUESTED*</b>	\$2,208	\$320,521

In figure 4.2., the use of the 48% applicable fraction reduces the amount of the tax credits requested from \$672,352 (as calculated in Figure 2.1) to \$322,729.

### EQUITY FUNDING GAP

The equity/funding gap takes into consideration the total sources and uses of funds required for the completion of the new construction, rehabilitation or acquisition and subsequent rehabilitation of a particular property. The basis for this form of analysis may be found in Section 42(m)(2)(B) of the Code, which states the housing credit agency should determine that level of tax credits that will be necessary for the development to be financially feasible as a qualified low income housing development throughout the credit period. In arriving at this determination, the housing credit agency is instructed to review the sources and uses of funds and the total financing planned for the development (Section 42(m)(2)(B)(i) of the Code) and also any proceeds or receipts expected to be generated by reason of tax benefits (Section 42(m)(2)(B)(ii) of the Code) or the syndication of the tax credits.

The Department, through the process of determining the eligible basis of a particular property, has already accomplished the function of determining the total development costs associated with the completion of the property. §50.9(f)(6) of the QAP requires that the development owner supply information concerning the proposed financing to be utilized towards the completion of the proposed development, that will be used in this calculation to offset the anticipated development costs.

The final component of the equity/funding gap calculation is the determination of the proceeds to be received through the syndication of the tax credits. In arriving at this determination, the Department will assume that the typical property will receive an equity amount equal to the current market rate for every dollar in tax credits allocated to the property. The equity factor used by the Department will assume the discounting which the investor will apply to the tax credits and also the cost associated with the arrangement of the limited partnership group through a syndication firm. The Department will utilize the equity/funding gap approach even in the instance where the development owner chooses not to sell the benefits of the tax credits to a potential limited partner.

Prior to discussing the formula for determining the level of tax credits that might be eligible under the equity/funding gap approach, the Department will provide some definitions or clarification pertaining to the components of the formula.

**Total Residential Costs** - The total residential costs are those development costs for both the acquisition and/or new construction/rehabilitation categories. It is important to note that this calculation utilizes those development costs that are considered ineligible under the qualified basis determination.

**Total Sources of Funds** - The total sources of funds includes all proposed or current funding that will be utilized on the development. In arriving at the total sources of funds the Department will be considering the permanent financing as opposed to interim financing. In the instance where grants are to be considered on a particular development, the applicant must include the initial amount of the grant as a source of funds under this calculation.

**Syndication Factor** - The anticipated value of the tax credits to the development owner. This is the percentage of each dollar that the syndication firms will pay for the tax credits. As previously stated the syndication factor will be assumed to be at the current market rate.

The basic formula for the equity/funding gap is as follows:

- Step 1: Total Residential Costs - Total Sources of Funds = Equity Funding Gap
- Step 2: Equity Funding Gap ÷ Syndication Factor = Total Value of Tax Credits
- Step 3: Total Value of Tax Credits ÷ 10 years = Annual Value of Tax Credits

In conducting this example, the Department will utilize components of the development cost schedule provided in Figure 1.1. In the calculation of the equity/funding gap, the costs used to reference the total uses of funds is the total

residential costs, which in the previous example totaled \$8,047,472. The Department will assume that the applicant was successful in obtaining mortgage financing equaling \$3,500,000.

**Figure 5.1**

Total Residential Costs (from Fig. 1.1)	\$8,047,472
Less: Total Sources of Funds	\$3,500,000
= Equity Funding GAP	\$4,547,472
/ Syndication Factor	0.72
= Total Value of Tax Credits	\$6,315,933
/ 10 Years	10
= Annual Value of Tax Credits	\$631,593

As shown in figure 5.1, under the equity/funding gap approach, it would be assumed that through the provision of \$631,593 per year in tax credits for the next ten years, that the applicant could transfer the benefits of these credits to a limited partner for \$.72 on the dollar and receive \$4,547,472 in equity capital that would offset the initial equity requirement.

The development owner will be eligible for the lower amount of tax credits generated by the qualified basis and equity funding gap approaches.

#### **DETERMINING THE MAXIMUM ALLOWABLE RENT TO BE CHARGED ON A SET-ASIDE UNIT**

As previously discussed in the section “What Must An Applicant Do To Qualify for Tax Credits” section, the development owner must agree to set-aside a certain percentage of the units for occupancy by persons of low and very low income. The units that are to be set-aside for low and very low income occupancy must also be rent restricted.

The portion of the Code that pertains to rent restrictions is Section 42(g)(2). In general, the rent that is allowed to be charged to a person or family of low and very low income under the tax credit program shall not exceed 30 percent of the imputed income limitation applicable to the units that is set-aside.

In Section 42(g)(2)(C) of the Code, imputed income limitation is considered to be the income that would apply to individuals occupying a unit if the number of individuals that occupied the unit were determined as follows:

1. in the case where the unit does not have a separate bedroom, one individual; and
2. in the case where the unit has one or more separate bedrooms, 1.5 individuals for each separate bedroom.

Figure 6.1 shows how the imputed income limitation parameters are utilized.

**Figure. 6.1**

Number of Bedrooms	Imputed Income Limitation
Efficiency	1 person
One Bedroom	1.5 persons
Two Bedrooms	3 persons
Three Bedrooms	4.5 persons, etc.

Once the imputed income limitation is determined for the various unit types in the development, then the process of calculating the maximum monthly rental rate can commence.

In calculating the maximum monthly rental rate that could be charged on a low income set-aside unit, it has previously been stated that said rent may not exceed 30% of the imputed income limitation applicable to the unit. Within this 30%, the applicant must discount any and all allowances for utilities that the tenant is responsible for paying directly to the service provider, pursuant to Section 42(g)(2)(B)(ii) of the Code.

HTC rent limits include an allowance for the cost of utilities (heat, lights, air conditioning, water, sewer, oil or gas). In developments where the owner pays all utilities, no adjustment in the HTC rent limits are needed to determine the maximum rent that can be charged for a tax credit unit. In developments where tenants pay all or a portion of their own utilities, the rent established for a tax credit unit must not exceed the applicable HTC rent limit for that unit. Depending on whether or not the HTC development receives additional assistance from other programs (such as FmHA, Section 8), owners may be required to use predetermined utility allowances. Owners of conventionally financed buildings may either rely upon local PHA determined utility allowances or calculate allowances themselves. If owners choose to determine utility allowances themselves, they must be able to document calculations as described in Treasury Regulation Section 1.42-10.

In this demonstration, the Department will calculate the maximum monthly rent that could be charged for both a one and two bedroom unit if the property were being set-aside for occupancy by persons and families at or below 50% of area median income. The Department will assume that the property is located in Abilene, Texas in performing the necessary calculations.

**Figure 6.2. Example of 2001 Income and Rent Limits for Abilene, TX MSA**

	1 person	2 person	3 person	4 person	5 person	6 person	7 person	8 person
50%	14,250	16,300	18,300	20,350	22,000	23,600	25,250	26,850
60%	17,000	19,560	21,960	24,420	26,400	28,320	30,300	32,220

  

	Efficiency	1 Bedroom	2 Bedroom	3 Bedroom	4 Bedroom	5 Bedroom
50%	356	381	457	529	590	651
60%	427	458	549	635	708	781

To arrive at the imputed income limit for a 1.5 person family, the applicant must add the one person income figure to the two person income figure and divide by a factor of two. The resulting number will represent the imputed income limitation for a 1.5 person family. The same basic process would be used to determine an imputed income limitation for either a 4.5 or 7.5 person family.

**Figure 6.3 Imputed Income Calculation**

Unit Type	1 Bedroom	2 Bedroom
Imputed Income Limit.	1.5 persons	3 persons
Income Determination:		
One Person Income at 50%	\$14,250	18,300
Two Person Income at 50%	\$16,300	
Sum of the above	\$30,550	
Divided by	/2	
Imputed income	\$15,275	18,300

Maximum Rent Determination:

Imputed Income	\$15,275	18,300
Refer to the Maximum Rent Limit Table for persons at 50%	\$381	\$457
Less Utility Allowance	-\$50	-\$75
Maximum Monthly Rental Rate	\$331	382

Under this demonstration, it is assumed that the tenants within the development will be required to pay for their utilities and the resulting allowance for the community in question for the sake of this example, \$50 is the utility allowance for a one bedroom unit and \$75 for the two bedroom unit. Consequently, the maximum monthly rental rate that could be charged to a person or family under the 50% median income requirement for a one and two bedroom unit would be \$331 and \$382 respectively. In the instance where the development owner would pay all necessary utilities, thereby relieving the tenant from the requirement to separately pay for the utilities, the maximum monthly rental rate could be as much as \$381 for a one bedroom unit and \$457 for a two bedroom unit. The process for calculating the appropriate rents for persons at the 60% income level would be identical except that the 60% limits would be used in the calculation.

The calculation of the maximum rental rate establishes the ceiling that may be charged under the requirements of the tax credit program, and not what should be charged to any particular tenant. The applicant must continue to be sensitive to the prevailing market rates in establishing the rents, all the while being conscious of the maximum rental rate that is allowed for under the tax credit program.

The imputed income limitation calculated in the process of determining maximum rental rates does not establish the maximum family income that a prospective tenant may earn and still qualify for the housing unit. The determination as to any particular tenants ability to qualify for a unit is limited to their income in relationship to the established HUD median income tables that corresponds to the number of people that will reside within the housing unit.

#### **DEVELOPMENTS LOCATED IN QCT'S, DDA'S, OR CERTAIN TARGETED TEXAS COUNTIES**

The Department has elected to provide certain special benefits to those applicants that produce housing in either qualified census tracts, difficult development areas or specifically targeted Texas counties. Those properties that are to be considered in either a qualified census tract or difficult development must conform to the provisions as set down within Section 42(d)(5)(C) of the Code. The definitions for both a qualified census tract and difficult development area were provided in the section dealing with the calculation of qualified basis.

#### **VALIDATING THE ALLOCATION OF TAX CREDITS BY YEAR END**

After the Department determines the feasibility of a development as an affordable housing development, and the maximum level of tax credits that are eligible to be claimed, those developments that pass all of the necessary tests will be presented to the Board of Directors of the Department for their consideration. Only the Department's Board of Directors may approve the commitment of any tax credits to a proposed housing development application.

Development owners receiving a commitment of housing tax credits will be required to satisfy all of the conditions present within the commitment, including but not limited to the full payment of any and all commitment fees as provided for in Section 50.21 of the QAP, prior to the expiration date provided therein. Once all of these conditions have been met, it is required that the development owner either complete the necessary new construction/rehabilitation (commonly referred to as placing the units into service) or file for a carryover allocation prior to the end of the calendar year. A carryover allocation will allow the development owner 24 months from the close of the calendar year in which said carryover allocation is issued to complete the necessary rehabilitation or new construction and place the buildings into service, pursuant to IRS Notice 88-116. Failure on the part of the development owner to either place the units into service or file for a carryover allocation by the specified expiration date stated in the commitment notice would result in the termination of the tax credits from the Department.

#### **CARRYOVER AND 10% TEST**

The specific regulations pertaining to carryovers are within Section 42(h)(1)(E) and Treasury Regulation Section 1.42-6, both of which are within the reference manual. The specific requirements by the Department pertaining to carryover eligibility is further described in detail in the Carryover Allocation Procedures Manual. All portions of the Carryover Allocation Procedures Manual must be adhered to when filing for a carryover allocation with the Department.

A property would qualify for a carryover only if the requirements of the Carryover Allocation Procedures Manual have been met. The following outlines basic qualification procedures for carryover allocations. A carryover allocation occurs when the development owner has not and will not be finishing the rehabilitation or new construction portion of the development prior to the end of the year in which the tax credit commitment is issued.

1. Commitment fee specified in the commitment notice has been received by the Department.

2. All conditions and requirements on Exhibit "A" Addendum to the commitment notice have been satisfactorily cleared with the Department.

No later than six months after the execution of the Carryover Allocation Document, the development owner must show that the basis in the development is more than 10% of the development owner's reasonable anticipated basis in the development (as of the end of the second calendar year succeeding the allocation year). Basis means the taxpayers adjusted basis of land and depreciable property that is reasonably expected to be part of the development, whether or not such amounts are includible in the eligible basis of the buildings in the development under Section 42(d) of the Code.

### WHAT IS REQUIRED TO PLACE THE DEVELOPMENT IN SERVICE?

The final IRS Forms 8609 are issued to development owners who complete their rehabilitation or new construction. For development owners applying for acquisition and rehabilitation tax credits, the acquisition of the property must occur in the year the development receives its allocation of tax credits. If the development will be completed prior to the end of the calendar year in which it receives its commitment notice for tax credits, the development owner must cost certify the development prior to the expiration date stated in the commitment notice. The following outlines the basic requirements of cost certifying a development for final allocation:

1. All conditions and requirements on Exhibit "A" Addendum to the commitment notice have been satisfactorily cleared with the Department.
2. Commitment fee and Compliance Monitoring fee specified in the commitment notice have been received by the Department.
3. Benefits and burdens of ownership have been transferred to the development owner and the federal tax I.D. number has been established.
4. The Declaration of Land Use Restrictive Covenants Document has been correctly prepared, executed and filed in the appropriate county real property records.
5. The Department has been presented with a cost certification audit and evidence that the new construction or rehabilitation work has been completed.
6. The development owner has attended a compliance monitoring workshop conducted by the Department and has received a certificate of completion from the Department for said workshop.

Development owners must adhere and comply with all portions of the Cost Certification Procedures Manual to be considered for the final allocation of the IRS Forms 8609. Development owners should allow a minimum of eight weeks for processing of the IRS forms 8609.

### AREAS OF DIFFICULTY EXPERIENCED BY APPLICANTS TO THE TAX CREDIT PROGRAM

To provide you as much information as possible concerning the tax credit program, the Department will cover some of the typical areas in the program that have given previous applicants difficulty.

1. **Failure on the part of the applicant to provide the Department with sufficient information in order for it to reach a determination concerning the application.** If the applicant does not submit sufficient information to the Department in order for a determination to be made as to either priority of the application, eligibility of the property under the requirements of the tax credit program, maximum amount of tax credits that may be permitted on the property, etc., then the Department will be delayed in processing the application. If the deficiencies under this scenario are not adequately addressed by the applicant, the property may be terminated by the Department.
2. **Failure on the part of the applicant to properly calculate the maximum amount of tax credits that might be eligible on the property.** By not properly calculating the amount of tax credits that are eligible to be claimed on any property, the applicant may either overestimate or underestimate the potential tax credit allocation. If plans and forecasts dealing with the financial structure of the development are taken into consideration, under the assumption that the initial applicants tax credit estimates are correct, and the Department subsequently recalculates the tax credit amount at a lower level, then the development owner

would be faced with the prospect of re-analyzing the transaction to determine the willingness to proceed under the new tax credit amounts.

3. **Failure on the part of the applicant to properly calculate the maximum amount of rents that would be allowable under the tax credit program.** When the applicant improperly calculates the maximum rental rates that may be charged under this program, and in doing so, bases the proforma operating estimates on the incorrect rental rate, the reduction in the maximum allowable rental amount may adversely affect the long term estimates of operating performance, and possibly reduce the properties viability under the tax credit program.
4. **Failure on the part of the applicant to properly satisfy the necessary year end requirements of the tax credit program.** As stated previously in this guide, the development owner is required to either place the units into service or file the necessary documentation to receive a carryover allocation of the tax credits prior to the end of the calendar year. Should the development owner receive a commitment of tax credits and fail to perform under either of these two alternative by the end of the calendar year, then the Department will terminate the tax credit commitment.
5. **Failure on the part of the applicant to adhere to application cycle deadlines or supplemental notice deadlines issued from the Department.** The applicant is advised to adhere to the deadlines with regards to any application cycle and any notice issued with regards to the property whereby the Department is requesting additional information To complete its analysis of the property.
6. **The applicant fails to provide the Department with a completed application package.** As stated earlier in this guide, the Department will not take the responsibility of insuring that all selection criteria issues, which would be eligible to be claimed on a certain property, have been provided in a satisfactory manner. It is the responsibility of the development owner to claim those selection criteria points that the application is eligible to receive. The Department will take the responsibility of either confirming or denying the claims made by the development owner with regards to the application exhibits.
7. **Application fails to score a sufficient number of points to be considered for tax credits.** When the application fails to score sufficient selection criteria points during a given application cycle, the application may not be considered for tax credits during that application cycle. This possibility takes on new meaning when the application cycle in which the development owner is competing in is the last cycle of any given program year. The failure to be considered during that final cycle could mean that the property will not be considered during that program year.
8. **The applicant fails to provide the Department with all of the information as requested within the threshold criteria (Section 50.9(f) of the QAP).** In order for an application to be considered for scoring and possible review by an underwriter, a development must first demonstrate that it meets the threshold criteria as set forth in this section of the Rules. Consequently, the failure on the part of the development owner to supply the information requested in the threshold criteria will force the delay in the underwriting process of the development and may cause the development application to be terminated.
9. **Failure on the part of the applicant concerning the purpose and benefits to be received from tax credits.** Tax credits are an ingredient that, when combined with other forms of financing, will foster the creation of affordable housing. The tax credit is a component of the overall financing package and not the whole package itself. Consequently, the development owner must also seek interim and permanent debt financing as well as arrange the manner in which he/she will provide for the required amount of equity to complete the property. It is highly advisable for the development owner to seek these other sources of funding while they are competing for the tax credits. Failure to consider the role of the tax credits in the development process and the corresponding year end requirements may result in the development owner receiving a commitment for tax credits yet be unable to satisfy the provisions necessary To validate the allocation.

### **MOST COMMONLY ASKED QUESTIONS ABOUT THE TAX CREDIT PROGRAM**

The following represent a sampling of common questions asked of the Department concerning the tax credit program. When possible, the Department will provide specific Code citations as a supplement to the answers provided. You are once again reminded that the Department will not provide any opinions concerning the Code and

its relationship to any particular real estate transaction; such opinions should be sought from qualified third party sources.

1. **How long does it take from the date of my application until I find out if I am to receive a commitment for tax credits?** The time between the date in which an application is submitted to the Department and date on which a determination is to be made as to who will receive a commitment of tax credits may vary. Generally, the Department will receive all applications during a given application cycle, and subsequently prioritize each application by score, pursuant to Section 50.9(d)(4) of the QAP. After all developments have been prioritized, the Department will commence the process of underwriting the most competitive files to determine eligibility for tax credits and viability as an affordable housing property during the compliance period. Applications that are found to be acceptable during the underwriting process, and have the highest priority, will then be presented to the Department's Board for consideration at its next scheduled meeting. It is only after this final process has been completed that the Department will issue commitment notices on any given application.
2. **What happens if my application is denied by the Department for tax credits during an application cycle?** Those applications that either did not meet threshold requirements, scored insufficient points to be considered for tax credits, or did not pass the underwriting process, may submit an application during another application cycle. Those applications which are denied tax credits on the basis that they do not qualify under the provisions of Section 42 of the Code may either require a more thorough revision or re-analysis on the part of the applicant as to its potential to qualify under the requirements of the Code.
3. **Do I need to hire a consultant for the purpose of applying for the tax credits?** A number of applicants have historically commissioned the services of consultants, whose primary responsibility is the completion of the application package in order for the property to be considered pursuant to the Rules that are in effect at that time for the tax credit program. Although there are a number of consultants that might provide assistance to a potential tax credit applicant, there is no requirement that a consultant be hired to successfully compete for the tax credits. The Department will conduct training sessions during which the tax credit program will be discussed in detail. The Department is willing to assist a potential applicant in the understanding of the tax credit program and the various requirements that must be met to apply. Finally, we hope that materials such as this information guide will assist you in understanding this program so that you feel confident enough in filing your own application, should that be your desire.
4. **Do I need to hire either a certified public accountant (CPA) or a tax attorney in applying for the tax credits?** As with the case in issue number three, concerning the absolute need for commissioning the assistance of a consultant, it is not generally necessary for the potential applicant to hire either a CPA or tax attorney in preparing the application for tax credits. However, the services of either a CPA or tax attorney may be required in the determination as to the requirements of the Code and their relationship to the real estate transaction in question. The usage of a CPA will be required at the time of carryover and placement into service, primarily for the purpose of providing the Department with certain required certifications and audits.
5. **When I am calculating the maximum rental rate of the tenants, and I am not paying for electricity (or some other utility) must I estimate the actual monthly utility expense to the tenant in determining the final eligible rental rate?** The answer is no. The development owner is not responsible for estimating the monthly utility consumption of the tenants in determining the maximum eligible rental rate. As previously discussed in this guide, the maximum rental rate takes into consideration that not more than 30% of the imputed income limitation may be charged for housing to a prospective tenant. In arriving at this 30%, the development owner must be aware of any utility costs that the tenant will be responsible for paying directly to the service provider. In the case where a tenant is required to pay electricity to the local provider directly, then, pursuant to Section 42(g)(2)(B) of the Code, the development owner must discount the maximum monthly housing cost by the applicable utility allowance as provided for under section 8 of the U.S. Housing Act of 1937. These utility allowances may be obtained from the local public housing authority and may change on an annual basis.
6. **What happens when I have leased a unit to a section 8 recipient and the fair market rent paid through the section 8 program exceeds the maximum rent requirements?** In the instance where a tenant in a property is receiving housing assistance under section 8 of the U.S. Housing Act of 1937, and

the payment made to the development owner exceeds that which is allowed for under Section 42(g)(2) of the Code, the unit will not cease becoming an affordable housing unit as defined by Section 42 of the Code. The point of law is found in Section 42(g)(2)(B) of the Code whereby the gross rent will not include any payments made under the section 8 program. Consequently, the development may receive rental assistance payments in excess of the allowable level and still maintain the unit as rent restricted. However, the development owner must understand that the tenants contribution towards rent may not exceed that amount that is allowed for under Section 42(g)(2) of the Code.

7. **When would the purchase of an existing apartment complex qualify for the acquisition tax credits?**

The most common provisions whereby the purchase of an existing structure would be qualified for acquisition tax credits are (1) when the owner from which you are to acquire the property from has had constant ownership of the property in question for a period of at least 10 years, and (2) when the seller of the property is an insured depository institution in default or from a receiver or conservator of such an institution. The RTC qualifies as a receiver or conservator of a defaulted depository institution. It is important to note that to receive the benefits of the acquisition credit when purchasing a property from the RTC, the development owner must file for a waiver of the 10 year Rules with the IRS. Only after such determination has been made by the IRS that the property's acquisition may waive the 10 year rule will the development owner be eligible to receive any final documentation from the Department concerning the acquisition tax credits. The complete provisions under which the purchase of an existing structure may qualify for acquisition tax credits is provided for in Section 42(e) of the Code.

### CONCLUSION

As stated in the first portion of this guide, the Department's intention in providing this information is to familiarize you with the requirements of the tax credit program. While the Department is sure that each person may have specific questions that this guide may not have sufficiently addressed, we hope that the information will provide an adequate foundation upon which you may build your understanding of this program.

The Department always stands ready to assist you in understanding the tax credit program and the means by which an application is to be presented. The Department will offer direct assistance to any individual that requires this service in the preparation of the tax credit application. However, the Department will not take the responsibility of completing the application package for you.

The Department looks forward to your continuing interest in the tax credit program and in the creation of decent, safe, and sanitary affordable housing for the citizens of the State of Texas.