

Tax Credit Advisor

News, Ideas and Information for
Tax Credit Developers and Investors

Issue Theme: Repositioning Properties

Approaching Year 15: Planning Tips, Exit Strategies for LIHTC Owners

By Robert L. Sheppard
Marcus & Millichap National Tax Credit Property Advisors

WITH THE BUZZ ABOUT LOW-INCOME housing tax credit (LIHTC) properties near the end of their initial 15-year compliance period and subject to extended use requirements, owners should proactively consider their exit options before this horizon approaches. To maximize the viable scenarios and the value of the property, preparation for Year 15 should begin around Year 9. This is the best time to explore var-

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Compliance Requirements for Section 42 Properties After Year 15

By A. J. Johnson

AS MANY LOW-INCOME HOUSING tax credit properties (LIHTC) near the end of their 15-year compliance period, owners and managers may be unsure of what will be required of them in terms of property compliance once the Internal Revenue Service's housing credit program rules no longer apply.

During the initial 15-year compliance period, the IRS program rules govern a tax credit property. After 15 years, the IRS is no longer involved in the property's operation. However, the state housing credit agency is responsible after Year 15, until the end of the extended use period, for enforcing the property's extended use agreement. Therefore,

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CASE STUDY

LIHTC Facilitates Life Rebuilding at Portland Project

AT 8NW8, A PROPERTY with an unusual name in downtown Portland, OR, the low-income housing tax credit has been more than just a financing tool. Rather, it has made possible a lifeline to special needs residents rebuilding their lives.

Named after its address (8 NW 8th Ave.), the development is a 180-unit "alcohol- and drug-free community" built and managed by Central City Concern, a local nonprofit. Located in the city's historic Pearl District, 8NW8 provides transitional and permanent housing plus various support-

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Low-Income Housing Tax Credit

Different Actions, Tactics Can Foster Quicker, Effective Lease-Up of New Tax Credit Properties

STRONG LEASE-UP OF NEW or rehabilitated low-income housing tax credit properties isn't a slam-dunk. Tardiness in filling units can trigger financial penalties for the developer, such as a delay and/or reduction in the final equity installment.

As a result, quick and efficient lease-up to qualified, creditworthy tenants is critical to successful tax credit development. In recent interviews with the *Tax Credit Advisor*, executives of several companies involved in tax credit development, management, and compliance discussed their experiences and provided advice.

How Long Should It Take?

First of all, the ideal length of time it should take to achieve lease-up and sustaining occupancy will vary from property to property. No one size fits all. "It's market dependent," says tax credit compliance consultant and ex-developer A. J. Johnson, president of A. J. Johnson Consulting Services, Inc., in Williamsburg, VA. "If you develop a new tax credit property in Manhattan, it would probably lease by lottery," he notes. "In other places, like Tennessee, it can take six to eight months to rent 100 units." In addition, Johnson says, "Properties that target seniors take 50 percent longer."

Lindy Ware, of Signature Management Corporation, Inc., Atlanta, says, "We average 26 move-ins per month for a typical new 150-unit tax credit multi-unit project," or a lease-up period of between six and nine months.

Similarly, Bethany Hooper, president of Humphrey Management, Columbia, MD, says, "For a 100-unit multifamily property, it takes about six months. If it's a senior property, maybe eight months."

Financial Penalties

The inability to meet original lease-up projec-

tions poses particular peril for housing credit developers, since they will likely suffer financial penalties – from the trigger of "adjusters" – if they fail to deliver the full amount of tax credits expected by investors, or if they deliver them late. Penalties here including for failure to achieve timely stabilization usually include a cut in equity or in the development fee.

Johnson adds: "If we [developers] tell investors we think we'll be able to lease up in nine months and we don't meet that expectation, some of the development money we expected in the first year may be moved to year 11."

Marketing, Advertising, Internet

Effective marketing to qualified prospective tenants is key to strong lease-up of a tax credit property. Marketing can include a variety of avenues – advertising, the Internet, direct mail, strategic partnerships, word of mouth, etc.

"The best advertising is drive-by," says Johnson. "Tied to that is curb appeal. If the property looks good people are going to stop in."

Johnson recommends the use of newspaper advertising, rental guides, and local apartment guides to market tax credit properties. On billboards, he advises to "make them interesting and provide directions to the property."

Johnson is cool on radio and television ads – these media aren't highly targeted. And he warns against direct mail campaigns targeted to select zip codes chosen for their racial composition. "If you do this," he cautions, "be aware of the Fair Housing issues," adding that race based-zip code marketing is a violation of the law.

As in most aspects of life, relationships matter as well when it comes to lease-up. In addition to leads from "walk-ins" and advertising, developers and man-

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Lease-up,

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agers should seek to find and forge relationships with partner sources that can provide referrals of qualified prospective tenants. Johnson indicates various public and community organizations can be a good source: public housing agencies, advocacy groups for the disabled, local agencies that serve seniors, and the like.

Johnson adds that some state housing credit programs even award extra points to applicants who plan to give priority in lease-up of their project to households on public housing waiting lists.

Research, Design

Michael Costa, president of Simpson Housing Solutions, LLC, Long Beach, CA, attributes his company's successful track record in lease-up of new tax credit projects to solid market research and preparation.

"What's crucial is solid research and having expectations based on the needs of the market," says Costa, whose company has 27,000 units under management. "I don't think you can spend enough on up-front research to make sure you are developing the right product."

He says Simpson carefully researches each potential market. "Sometimes we will find that people are paying as high as 50 percent of their average monthly income for market-rate housing. We'll come in with better apartments for \$100 to \$150 less. Lease-up under those conditions is a no-brainer."

Costa also cites project design as a key influence on the lease-up rate. "We design our product so that when you walk in it has the feel of market-rate property," he says. "We simply apply the market-rate process to affordable housing."

Particular amenities are crucial, Costa points out. "I make sure all my communities have a nice clubhouse," he says. "It's important to create a lifestyle, and that includes things like an active clubhouse, after-school educational programs, and computer classes. It becomes a perceived privilege to live in this kind of community."

Also important is leasing up the "right way." Tom Capp, chief oper-

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Calendar of Events

**National Housing & Rehabilitation Association
2007 Annual Meeting**

March 14-18, 2007 • The Boca Raton Resort & Club • Boca Raton, FL

**National Housing & Rehabilitation Association
2007 New Markets Tax Credit Symposium**

March 14, 2007 • The Boca Raton Resort & Club • Boca Raton, FL

**National Housing & Rehabilitation Association
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MarketSketch

Ohio Tax Credit Vacancy Statistics Can Help in Choosing New Sites

By Rob Vogt, VWB Research

TO HELP DEVELOPERS SITE new low-income housing tax credit projects in appropriate locations, the Ohio Housing Finance Agency (OHFA) provides comprehensive data profiles for each of Ohio's eight metropolitan areas and 88 counties. This information offers insights into the status and overall health of tax credit housing in all of Ohio.

The latest data reflect survey statistics for 25,500 tax credit units in three categories of LIHTC projects – single-family (one unit), multifamily (2+ units), and senior (restricted to or intended for older residents). OHFA collected the data in its year-end 2005 compliance survey, and determined the status of each respondent qualified property.*

The survey concluded that the overall tax credit rental vacancy rate for properties within Ohio's eight metropolitan areas, regardless of any additional subsidies, is approximately 9.1%. This is generally higher than the rate for Ohio's overall rental housing market.

The eight metropolitan areas include Akron, Canton, Cincinnati, Cleveland, Columbus, Dayton, Toledo, and Youngstown.

OHFA's survey collected data not only for the eight large metro markets but also for smaller submarkets within the larger metropolitan areas. Information for these submarkets is provided by project type. Detailed occupancy data of this kind can often sharpen, what can be, a genuinely cloudy picture for developers as they try to deter-

mine the best site for a new tax credit project. When assessed properly, the information made available by OHFA can help developers better identify specific areas with strong potential to support additional tax credit projects.

Rate Lowest for Senior Projects

For Ohio's eight metropolitan areas, senior tax credit properties have the lowest vacancy rate, 4.1%. To a certain degree, this reflects the state's current demographic trend of significant population growth in older adults.

Single-family tax credit projects have a vacancy rate of 5.9%, while the highest vacancy rate of the three categories – 11.0% – is for multifamily credit properties. It is significant that tax credit properties with additional subsidies, such as projects assisted by rent subsidies under HUD Section 8 Housing Assistance Payment (HAP) contracts, are included in OHFA's statistics. Often, Section 8 HAP tax credit properties have significantly lower vacancy rates than non-subsidized credit projects.

Among the eight metropolitan markets, the Akron metro area has the lowest overall tax credit

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VACANCIES BY TAX CREDIT PRODUCT TYPE

Metro Area	Multifamily	Single-Family	Senior	Overall
Akron	6.1%	4.3%	3.6%	5.8%
Canton	26.9%	6.5%	7.6%	8.2%
Cincinnati	14.7%	52.8%	4.1%	14.8%
Cleveland	14.3%	3.5%	2.5%	7.9%
Columbus	8.9%	8.9%	7.1%	8.8%
Dayton	9.0%	6.2%	4.6%	7.4%
Toledo	15.7%	5.9%	3.3%	9.6%
Youngstown	23.7%	4.9%	0.6%	7.5%
Overall Vacancies	11.1%	5.9%	4.1%	9.1%

Source: Ohio Housing Finance Agency; statistics as of December 2005.

* Cited statistics are as of December 2005. OHFA is currently collecting updated statistics that will be as of December 2006 that it will post later this year on its Web site.

MarketSketch,*continued from page 6*

vacancy rate, 5.8%. The Dayton and Youngstown metro areas are next lowest, at 7.4% and 7.5%, respectively. The Cleveland metro area, the largest in Ohio, has a 7.9% vacancy rate. The Cincinnati metro area has the highest vacancy rate, at 14.8%. Nevertheless, closer examination reveals an opportunity may exist in Cincinnati for development of senior tax credit projects; the vacancy rate for this type is just 4.1%.

Significantly, OHFA's survey results include a number of non-revenue vacant units, which normally are not included in conventional market surveys. We believe that inclusion of these units somewhat inflated the resulting vacancy numbers. Based on our own data, we believe that OHFA's reported vacancy rates are two to three percentage points higher than those typically reported. Our view is that the overall vacancy rate for tax credit properties in Ohio's metro areas is 6.8% to 7.1%.

Further Investigation Necessary

Of course, additional data collection and further analysis should be completed to determine whether tax credit project vacancy levels (high or low) in a selected market are related to: the available product; the surveyed project's site location; the project's management; the market itself; or a combination of one or more of these factors.

Throughout the Midwest, lackluster economies and slow household formation have affected both conventional and multifamily tax credit development.

MarketSketch,*continued on page 10*

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Case Study,

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ive services to very low-income single residents in recovery from problem alcohol or drug use. Since opening in 2004, nearly 700 formerly homeless individuals have lived at 8NW8, both men and women but more often males.

The project was recently recognized for its success as the inaugural winner of the I. Donald Turner Prize for Innovation and Leadership in Affordable Housing. The award is named after the late Donald Turner, a housing visionary and founder and longtime leader of BRIDGE Housing Corporation, a California nonprofit housing developer.

Creation of Community

In an interview with the *Tax Credit Advisor*, Traci Manning, Director of Housing for Central City Concern (CCC), said 8NW8 embodies the principles of the model for successful alcohol and drug-free communities that CCC Executive Director Richard Harris helped develop. She noted when Harris first came to Portland to run the group's Detoxification Center, he saw graduates of the treatment program who wanted to start a new life but found themselves on the street. "They had a hard time staying clean when they didn't have any place to live," says Manning. "Or the place they found to live was a flophouse where people were shooting up or getting drunk."

At 8NW8, residents participate in recovery programs and various other services and facilities designed to help them keep healthy, acquire life skills, and ultimately become

self-sufficient. Key to the process, according to Manning, is encouraging and building "community" among the residents. She noted that residents arrive generally having used drugs or alcohol all their adult lives, with the people they have known up to that point generally all users, too. "So they need to form a new community to be successful in recovery," Manning says.

Part of the formula for fostering community is appropriate physical design. The project was designed collaboratively between CCC and SERA Architects, Inc., a local firm. The 12-story, L-shaped building contains 120 single-room occupancy (SRO) apartments (the transitional housing units) and 60 studios (the permanent housing units), plus ample common spaces intended to prompt residents to interact, socialize, and support one another. For example, each floor of SRO units has a corner community room where residents go to cook meals, and which has a balcony with splendid views of the city. Manning said creating community has a lot to do "with providing opportunities for the residents to interact." She noted SRO buildings work "extremely well" for building community among residents. "It forces people out of their rooms and into the halls to meet each other."

She said the project's design incorporated the use of durable materials, various energy-efficiency features, and artwork on the elevator banks to foster a sense of home. Manning indicated that 8NW8, because it was new construction rather than rehab of an existing building with inherent constraints, enabled CCC to design and build the optimal alcohol- and drug-free community.

Targeting, Leases, Services

All 180 apartments are low-income housing tax credit units. The 120 SRO units are rented to individuals at or below 30 percent of area median income (AMI); the 60 studios, to individuals at or below 50 percent of AMI.

The SRO units have leases that vary in length according to the particular program a resident is in, but generally range from six to nine months.

Manning said nearly all residents arrive without any income, particularly those moving into the SROs. SRO residents generally don't have jobs; "We're moving them toward employment," she notes. Residents of the studio units are helped to get their GED diploma, a job, or whatever other appropriate steps they need to become self-sufficient and move forward.

Manning said residents sign a lease that allows CCC to evict a resident in less than 30 days for use of alcohol or drugs, on or off the premises. "They commit to work an ongoing program of recovery, to provide quarterly verification that they are working the program, and [that] they can be subject to urinalysis."

A varied set of programs and services for residents operate within the building, each with its own government funding source.

Among these are a detoxification program, an on-site health services clinic operated by CCC, a program for residents with HIV and AIDS, and a program for women just out of correctional institutions. The programs have case managers, and there are "mentors" as well.

Manning said the property's operating budget funds some addi-

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tional” light” services, such as staffing of a 24-hour front desk, eviction intervention assistance, and referrals to other services.

Funding Sources

The project had a total development cost of a little more than \$18 million.

Funding sources included: \$4.363 million in equity raised from the housing tax credit (9 percent allocation) and provided by investor US Bancorp Community Development Corporation; a \$2.981 million first mortgage from US Bank; \$1 million in equity from CCC that represented funds from the county;

\$9.8 million in tax increment financing (TIF) from the Portland Development Commission; and \$257,000 in “systems development charge waivers.” The latter are certain standard fees (e.g., sewer, water, etc.) charged by the city to sponsors of new developments. The city can waive some of these fees for affordable housing projects.

Advice, Lessons

Manning offered some advice to other developers thinking of doing a similar project. “Pay a lot of attention to building community,” she noted, and to use of durable building materials and appropriate design. “The durability of materials doesn’t mean it needs to look like an institution,” Manning said. She

noted CCC initially told the architects chosen to design 8NW8, “We want... a building that’s going to last for a hundred years. But that feels like home.”

If CCC were able to do the project over again, Manning said one possible change might have been to put less subsidy into the studio units; 55 of the 60 studios have HUD project-based Section 8 rental assistance. Manning indicated that initial fears by some about difficulty in renting the building’s units – due to their small size – proved to be unfounded. She said the apartments have actually been “easy to rent... The building is amazing; it’s gorgeous. Everyone wants to live there.” ■

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Lease-up,*continued from page 4*

ating officer of Gorman & Co., Madison, WI, says, “We have a tight set of criteria for the initial lease-up. The cost of leasing to the wrong people is much higher than holding out a few months to make sure you get the right people.”

Taking advantage of modern technology, including the Internet, can also help speed lease-up of a tax credit property.

Johnson says, “We are seeing more and more Web-based processing” of rental applications. “Probably the newest trend today is to go right to the property’s Web site, fill out an application, and set up an appointment.”

Concessions, Alternatives

In challenging situations – caused perhaps by a weak local rental market or strong competing projects – a developer may be tempted to resort to concessions to attract residents.

Johnson says many developers use or consider rent concessions – either by reducing asking rents or by providing one or more months of “free rent” to new residents.

But he warns developers and managers to be careful here. “In my training programs,” Johnson says, “I emphasize avoiding rent concessions. It makes you look desperate. Yet concessions are used frequently because they’re so easy.”

For developers who feel they must provide concessions, he suggests alternatives to “free rent,” such as:

- Offering “free” amenities, such as ceiling fans or microwaves;

- Paying the tenant’s security deposit, and returning it to the tenant at the end of the lease term; or,
- Returning the tenant’s security deposit after the first year rather than after move-out.

If a developer is insistent on providing a month of “free rent” to attract new residents, Johnson recommends making it the 12th rather than first month of the lease.

Be Creative

Finally, developers and managers should always be open to thinking “outside the box” in their lease-up tactics.

Johnson, for example, described a situation where a client developer was struggling to fill a property stalled at an occupancy rate in the mid-80s [percent] range.

He says he asked about the property’s rental policies, and was told by the client that dogs were limited to those under 35 pounds. Asked the reason for this, Johnson says, “He said that’s what everybody else does.

“I suggested he allow bigger dogs,” Johnson continued. “Studies show that bigger dogs bark less, bite less, and do less damage.”

Johnson advised the client to run a newspaper ad that said, “Big Dogs Welcome” – and the client did. “In eight months,” Johnson notes, “his occupancy rate had climbed to 92 percent.”

– James T. Berger

NEXT MONTH: Effective Strategies for Tenant Retention

MarketSketch,*continued from page 7*

Developers always want to maximize their opportunities and protect existing assets. Consequently, developers should exercise care when selecting locations for future proposed tax credit projects.

The OHFA data can be a valuable tool for cautious developers. OHFA makes a genuine effort to assist developers and encourage targeted tax credit housing development. In addition to evaluating its own portfolio, OHFA collects market-specific vacancy data, and information on the share of local qualified households already served by tax credit housing.

Any developer working on tax credit projects in Ohio will likely find OHFA’s data enlightening. It can be used in a number of different ways. The best possible use, though, is probably to use conclusions drawn from an analysis of this information to guide the decision on a suitable location for a new tax credit project. Developers can use OHFA’s statistics to site new projects in areas that have low vacancy rates for tax credit and market-rate properties and/or where a low share of current local households are already served by the tax credit program.

[Note: OHFA’s survey statistics are at <http://www.ohiohome.org/lihtc/default.htm>. Additional information, <http://www.vwbresearch.com>.] ■

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Exit Strategies,

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ious sale opportunities and allows the greatest flexibility in executing the most desirable option.

To choose the best strategy, owners should understand the following three key components of each LIHTC asset:

1. Relevant program-related and partnership documentation;
2. Operational history/trends of the property and partnership; and,
3. The motivations of the partners in the ownership entity.

By addressing these areas as early as Year 9, owners can explore all the options with plenty of time to select and execute the choice that best suits their needs. Marcus & Millichap National Tax Credit Property Advisors, which handles the sale of LIHTC properties, has found that nearly every tax credit investor is seriously interested in exiting when the tax credits are complete and as soon as it makes financial sense. For some, this means Year 15; but, for most others, it means Year 10.

Depending on the property's timing within the tax credit life cycle, exit options can include a fee simple transaction; a partnership interest sale; a sale for resyndication; or, for troubled properties, a sale of the real estate along with the remaining tax credits.

Options for Years 10-15

After Year 10, our experience shows that the maximum value of most tax credit properties is achieved through a fee simple real estate sale. At this point, the limit-

ed partner has received all the benefits from the tax credits and may be less motivated to stay involved through the duration of the initial compliance period (let alone the extended use period). Cash flow buyers are becoming more aware of the potential rewards of purchasing and repositioning a tax credit property (typically with a minimal cash infusion), and generally are not deterred by extended use requirements.

There are three primary motivations to sell during Years 10-15. These include:

1. **Strong market conditions.** Affordable properties certainly benefit from hot markets and super-charged capital markets.
2. **The property requires intensive maintenance or capital infusion.** There is more value in selling to recoup equity than expending the required capital and selling later.
3. **The property is struggling operationally.** Many buyers consider themselves excellent operators and feel they will be able to achieve operational upside by intensively getting into the day-to-day operations and turning the property around.

Because the fee simple interest can be sold in Years 10-15, thereby offering a straightforward exit option, the only time an owner will want to sell the partnership interest is if the property is worth more as a resyndicated tax credit property. In most states, this value assumption is predicated on the resyndication occurring after Year 15 using housing

tax credits or tax-exempt financing (bonds + 4% tax credits). Selling the general partnership interest (i.e. the general partner interest in the limited partnership) will allow this, though the transaction will be more complex.

Options Beyond Year 15

Sales after Year 15 are almost always fee simple real estate sales rather than partnership interest sales. Most partnerships are structured to wind down at approximately this point, making it more practical and profitable to sell the real estate. The sale process is similar to a conventional "market rate" real estate sale (for example, a surety bond is not required). However, it is critical that the underwriting and the education of the buyer address the LIHTC program complexities clearly and concisely to ensure that the seller will achieve maximum value.

If it has had the same owner for the past 10 years, a property will be eligible for acquisition tax credits, making an acquisition/rehabilitation transaction an attractive option. If an asset is a good acquisition/rehab candidate, a tax credit developer can likely pay a higher price for the property than a conventional buyer. The attraction for tax credit developers is that an existing LIHTC property allows for 100 percent delivery of tax credits in the first year due to its already-qualified tenant base.

A potential downside of selling to a tax credit developer is that the sale will almost always be contingent on the allocation of tax-exempt bonds or tax credits. As a result, if the buyer fails to receive the bonds or credits, the transaction likely will not close on the terms and timing of the purchase and sale agreement.

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Exit Strategies,*continued from page 11*

Often this process involves a much longer timeframe than a sale to a “market rate” buyer. At the same time, though, waiting may yield a higher price.

Options for Year 9 and Earlier

To sell an asset that is still in the credit flow years, there are generally two viable options:

1. Selling the real estate and the remaining credits as one sale (both the general partnership and limited partnership interests together); or,
2. Selling the general partnership interest.

The market is growing for both options. In most scenarios we have seen, owners are either seeking an exit option that allows them to capitalize on market conditions and monetize their value (both residual and cash flow), or they are trying to minimize or alleviate the costs of maintaining their interest in a struggling asset.

Even a struggling asset can be valuable as real estate. Particularly when combined with the value of remaining tax credits, the market is healthy and buyers are seeking new market opportunities. Buyers we have worked with include active tax credit developers as well as cash flow and long-term yield buyers who take a hands-on approach to generate upside and long-term gains by repositioning the property.

When considering a partnership interest sale, a key factor is the timing (i.e. where the property is in its lifecycle). Additionally, most partnership sales require mutual

approval of the limited and general partners.

Recommended strategies:

- If a general partner is looking for an exit strategy in Years 1-5, and the limited partner does not want to sell their interest (which will almost always be the case), the general partner can sell their partnership interest.
- In Years 6-8, owners will want to evaluate whether the economic value of the property is greater or less than the value of their partnership interest. If there is significantly higher value in a real estate play, waiting until Year 10 to execute a fee simple sale is usually best (a surety bond or U.S. Treasury obligation must be posted, though).
- In Years 7-9, if the property is struggling and costs are too high to bridge the gap until Year 10, a partnership interest sale should be considered.
- In nearly every Year 9 situation, it makes the most economic sense to wait until Year 10 to sell the property as a fee simple real estate transaction, unless the property is worth more under a resyndication scenario. If the resyndication value is not higher, a fee simple transaction will allow the owner to avoid the complications of a partnership sale. Beginning to market the property in Year 9 and closing immediately upon completion of the credit flow period in Year 10 is common.

Robert L. Sheppard, based in Seattle, WA, is the Senior Director of Marcus & Millichap National Tax Credit Property Advisors, a specialty group within Marcus & Millichap real estate brokerage firm, that to date has closed more than 130 housing credit property transactions valued in excess of \$825 million in 26 states. He may be contacted at 206-826-5770. ■

Compliance,*continued from page 1*

owners and managers must be familiar with the applicable state agency rules that will apply to the property during this minimum 15-year time frame.

Before describing these possible state requirements, an overview of the requirements for the compliance and extended use periods is in order.

Properties with post-1989 tax credit allocations must have an Extended Use Agreement (also known as a Land Use Regulatory Agreement, or LURA, Regulatory Agreement, etc.). This agreement must be recorded in the jurisdiction in which the property is located. Internal Revenue Code Section 42(h)(6)(J) bars a claim of housing credits for any year if, at the end of such year, a recorded extended use agreement isn't in place.

The Extended Use Agreement (EUA) is a restrictive covenant entered into between the property owner and the state housing credit agency (HCA).

The EUA has a minimum term of 30 years; the initial 15-year compliance period, plus another 15 years (or longer, if mandated by the HCA). During the initial compliance period, projects must comply continuously both with IRS rules and the requirements of the property's EUA.

An extended use agreement must state that:

1. The applicable fraction (the percentage of the building occupied by low-income residents) must be maintained throughout the term of the agreement;
2. Leases of low-income tenants can't be terminated other than

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continued on page 13

Compliance,*continued from page 12*

for “good cause,” and rents of units for low-income tenants can’t be raised above the allowable tax credit program rent limits;

3. Income-qualified individuals may enforce the EUA in state court;
4. No portion of the building may be sold (i.e., only entire buildings may be sold);
5. Households with HUD Section 8 vouchers can’t be denied for residency simply because they hold a voucher;
6. The EUA is binding on all successors; and,
7. The EUA must be recorded in the court of local jurisdiction.

While an EUA must have a minimum term of 30 years, it may be terminated earlier for reasons of:

1. Foreclosure (or instrument in lieu of foreclosure); or,
2. Failure of the HCA to find a qualified contract purchaser for a property within the one-year window following the owner’s request.

The end of the 15th year marks the end of the IRS’ involvement in a tax credit property as far as federal program rules go; the HCA now becomes sole enforcer of any regulatory agreements for the rest of the extended use period. Therefore, owners and managers will need to be aware of and follow any requirements of the state HCA for the remaining 15 (or more) years of the extended use period.

Each state credit agency will be establishing its own rules for

extended use compliance after year 15; in fact, a number of states have done so already. Readers, therefore, should check for any requirements already in place in the states in which they work and have properties.

There are differences among the extended use compliance requirements issued to date by various state agencies. But there are enough similarities to discern a pattern, knowledge of which can give tax credit project owners and managers an idea of what to expect during the extended use compliance period.

Examples of some state extended use compliance requirements that operators of tax credit properties will need to start following after Year 15 include:

- Complete verification of tenant eligibility at move-in, following HUD Section 8 guidelines;
- Maintenance of restricted rents with LIHTC rent calculation methodology normally required (all states will require rent restrictions).
 - Some states may adjust the methods used to determine utility allowances;
- Student eligibility requirements will be amended in virtually all states. The requirements will range from following HUD Section 8 student criteria to elimination of all student restrictions;
- Tenant recertification requirements will likely be altered. Examples of the revised requirements include:
 - A simple list of household members and rents charged, with no statement of income (North Carolina);
 - Tenant self-certifications of income with no verifications

Compliance,*continued on page 14*

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Contact: Brian Gallagher, 212-271-5096, bgallagher@cdt.biz

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Contact: Stephen H. O’Connor, 212-271-5107, soconnor@cdt.biz

www.cdt.biz



Compliance,*continued from page 13*

- (South Carolina); and,
- No recertification required for 100 percent low-income properties (Wisconsin, Minnesota, Pennsylvania);
 - HCAs will determine how to deal with changes in household composition.
 - For example, North Carolina will require full verification and certification if new adults are added to a household. If the revised income exceeds 200 percent of the current income limit, the household will have to vacate the unit;
 - Most states will not place specific restrictions on unit transfers, whether in the same building (Building Identification Number, or BIN), or between buildings;
 - Many HCAs will require monthly online reporting of unit activity;
 - Annual owner certifications will be required in most cases;
 - Property inspections (both physical and file) will still be required, but will vary from state to state.
 - North Carolina and Wisconsin will perform every three years;
 - South Carolina, Minnesota, and Pennsylvania will review every five years; and,
 - The percentage of files and units reviewed will vary, from at least three units per project (Minnesota) up to 20 percent (South Carolina and Pennsylvania);
 - In some states, the LIHTC program's "available unit rule" and "vacant unit rule" will be eliminated.

- In others, the same rules will apply;
- Calculation methodology for the applicable fraction is likely to change (or be eliminated); and,
 - Some states (e.g., Minnesota) may eliminate the monitoring of HUD or Rural Development properties with extended use agreements.

What will be the penalty for non-compliance during the extended use period?

The answer will vary by state. But the trend from extended use procedures already developed by HCAs is that non-compliance will result in owners being placed in the status of "not in good standing." In most cases, such owners will not be eligible to apply for additional tax credits. All extended use agreements are recorded restrictive covenants; as a last resort, HCAs may enforce the agreement requirements in state court.

Conclusion

Many states have not yet published guidance for compliance after Year 15. Therefore, program participants should work with these states that have not done so yet to help ensure adoption of reasonable policies. This effort will hopefully assist HCAs in establishing procedures that protect the interests of all program participants and the long-term integrity of the credit program. ■

A. J. Johnson is president of A. J. Johnson Consulting Services, Inc., a Williamsburg, VA-based full service real estate consulting firm specializing in due diligence and asset management issues, with an emphasis on low-income housing tax credit properties. He may be reached at 757-259-9920, ajjohn@cox.net.

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Repositioning Older and Underutilized Properties

Repositioning Older Projects Offers Opportunities; Candidates, Approaches Differ

FOR DEVELOPERS TOM CAPP and Charles Allen, “repositioning” affordable rental housing projects mean more than just making a buck. Their strategy usually also means helping a community solve a problem.

Their approach is just one that developers are using to do repositioning deals. A growing national pool of aged affordable rental projects, combined with available funding sources, incentives and preferences for preservation deals, and other factors, is boosting opportunities for owners and developers for repositioning or “turnaround” transactions including acquisition/rehabs. Candidate properties, ways to reposition, and potential funding sources differ. But recent interviews by the *Tax Credit Advisor* with a handful of industry participants revealed some guiding principles that can help identify opportunities, create profitable transactions, and avoid mistakes.

Those interviewed were: Tom Capp, chief operating office, Gorman & Company, Inc., Madison, WI; Charles Allen, Evergreen Partners, LLC, Ipswich, MA; Michael Bodaken, president, National Housing Trust, Washington, DC; Robert L. Sheppard, senior director, Marcus & Millichap National Tax Credit Property Advisors, Seattle; Todd Trehubenko, senior vice president, Recapitalization Advisors, Inc., Boston; David Ross, principal, Novogradac & Company LLP, Columbus, OH; and Judith K. Martin, CPM, East Region president, and Terry L. Town, CPM, vice president, both of American Management Services East LLC/Pinnacle, Winter Park, FL.

Definition of Repositioning

Repositioning means taking an existing, underperforming affordable rental housing property and making various changes (physical, financial, operational) to resolve existing deficiencies, enhance the property’s appeal and value, and generate a profit for the developer or owner. Though conversion to market-rate use often is an option in repositioning, this article will focus on

transactions to preserve affordable rental use.

Physical changes usually involve substantially rehabilitating or even rebuilding the existing development. Financial changes may mean refinancing or bringing in additional subsidies or investor capital to put the property on a better fiscal footing, facilitate a change in ownership, or fund needed renovations. Operational changes may mean changing or beefing up property management, altering policies, adding services, or taking steps to correct problems.

“It’s taking the property that’s underperforming, or has economic or functional obsolescence; correcting those issues; and improving the value of the real estate,” says Martin, whose firm offers a full range of real estate services including multifamily property management and preparation of repositioning plans.

Solving Problems

Naturally, repositioning transactions must make economic sense to the owner or developer. Potential financial returns include the standards such as development fee income, increased cash flow, management income, and possible residual benefits.

Still, for many developers it’s possible to “do well by doing good.”

“A lot of our work is seen as solving problems for communities,” says Capp, whose company – as part of its business – develops affordable rental housing both through new construction and acquisition/rehabilitation, including repositioning transactions.

As an example of the latter, Capp said a mayor approached his firm with a request to “fix” a problem “barracks-style” affordable rental development that had become local “housing of last resort.” He noted 120 of its 150 units were tiny small three-bedroom apartments, each 890 square feet. Capp said his firm substantially rehabilitated the property, including changing the mix and size of units; all the

Repositioning,*continued from page 16*

three-bedrooms, for instance, were reconfigured into two- and one-bedroom units. The developer also put in a community center and pool and made other changes, Capp noted, to deliver “a modern development that was not a problem for the community anymore.”

Capp indicated his firm’s strategy for repositioning transactions is to make substantial renovations that upgrade and modernize a property, to make it “amenity rich,” and to take other steps that will ultimately provide the residents with a good place to live and the community with a valuable asset that will last another 40 years.

Evergreen Partners is doing much the same in solving a problem for the city of Glens Falls in Upstate New York. There, Allen reported, his firm will be demolishing a rundown HUD Section 221(d)(3) development on a key site across from the local hospital, and replacing it with a modern new apartment community of three buildings with 136 affordable rental units, a community room, and management offices. HUD Section 8 rent subsidies will be continued for all units, and existing residents won’t be displaced during the rebuilding.

Allen noted the existing project, roughly 35 years old, includes 20 townhouse apartment buildings in poor physical condition, made of substandard materials and laid out poorly. “It has inhibited in many ways the city’s efforts to bring revitalization into the city, reinvestment into the downtown,” he said.

Funding sources for the new

Repositioning,*continued on page 18*

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Repositioning,

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\$26 million development include equity generated by the 9 percent low-income housing tax credit, federal HOME funds (1%, 30-year note), and some hard debt.

Types of Candidates, Signs

There are many different types of affordable rental housing properties that may be good candidates for repositioning transactions. These include: older HUD-assisted and/or FHA-insured projects [e.g. Section 236, 221(d)], older properties with HUD Section 8 rent subsidies, distressed public housing projects, older bond-financed developments, mature low-income

housing tax credit projects, and other kinds of federally or state subsidized or assisted projects.

Trehubenko noted many older HUD and state subsidized/assisted projects are becoming ripe for development because they have or will soon reach the age at which their government-insured mortgage may be prepaid. Various opportunities for sale and repositioning, involving either existing owners or new buyers, are available. "Many of these properties were built with the first 20 years in mind," he said. "So there tend to be opportunities around properties that have reached the end of that initial period."




Bodaken said one big chunk of potential candidates are Section 8 projects. He noted the current

inventory contains projects (average size: 110 units) with about 1.5 million project-based Section 8 units; the vast majority of these projects also have some type of FHA loan. In any given year, Bodaken said, about 45,000-50,000 of these units are preserved, developed, or rehabilitated using the LIHTC.

Bodaken noted, however, that there are different "flavors" of Section 8, with some projects more lucrative than others for acquisition/rehab or repositioning transactions. "What you're looking for generally," he said, "is a Section 8 property where the rents can be modified to market – either marked up or marked down [under HUD's mark-up-to-market or mark-down-to-market programs]" and the existing FHA loan paid off. He cited as "ideal" HUD Section 236 projects in which the current stream of HUD mortgage interest subsidy payments (IRP) can be "decoupled" from the existing FHA-insured loan, which is then paid off. Often decouplings occur in connection with a sale to a new owner combined with rehabilitation.

Sheppard said older LIHTC projects – the oldest are now nearly 20 years old – can also be attractive candidates for repositioning, either by the owner or a new buyer. Owners may wish to reposition their property to prepare it for sale to generate the highest sale price; buyers may see an opportunity to acquire a property and make changes that will boost income.

Sheppard said the LIHTC projects "that actually can be resyndicated now, that have hit their 15th year [of the tax credit compliance period], those are very attractive right now, if

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Repositioning,*continued from page 18*

they're in the right markets. We get a lot of people pursuing these."

Finding Candidate Properties

The participants interviewed said there are different ways for developers to find properties ripe for repositioning. One way, Capp and Allen noted, is to talk to local government officials and ask them to identify the current problems they have. Other possibilities cited by those interviewed include talking to existing project owners to see if they may be interested in selling, using real estate brokers, and putting out word through current relationships and networking.

Sources said there are different

signs that indicate properties may be ripe for repositioning transactions: advanced age, physical deterioration, ill or outdated design, lack of standard modern amenities, high vacancies, poor management, problems on-site or in the neighborhood, substandard rent levels, paltry reserves, etc. Whatever they are, they often are things that usually make the property less competitive in the market and reduce rental income.

Participants said it is crucial to have a detailed plan when repositioning a property.

Martin and Town described set standard procedures their firm follows to prepare repositioning plans for affordable housing properties for clients – owners, buyers, or prospective buyers. (*To view, go to*

<http://www.housingonline.com/Portals/o/turnaround.pdf>.)

"Initially we'll do a very thorough due diligence to figure out how [the property] got to where it is, where it needs to be, and how were going to get where it needs to be," says Martin. She said the firm then conducts a thorough physical inspection of units and common areas, a market survey to determine comparable property rents, reviews of the financials and marketing activities, an evaluation of the tenant profile, and takes other steps, and then develops recommendations for remedial actions.

Several sources mentioned what works – and what doesn't.

Ross analyzes failed tax credit projects, including repositioning

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Historic Rehabilitation

Preservation Easements Can Offer Extra Benefits to Owners, Developers

PRESERVATION EASEMENT DONATIONS can generate additional financial benefits for owners and developers of historic buildings. But care must be taken in structuring them to assure compliance with federal tax law requirements strengthened by legislative reforms in the Pension Protection Act of 2006 (H.R. 4, P.L. 109-280), signed 8/17/06.

Professionals familiar with easement donations interviewed by the *Tax Credit Advisor* for this article included: Paul Edmondson, vice president and general counsel, National Trust for Historic Preservation, Washington, DC; Washington, DC attorney Richard Nettler, partner, Robins, Kaplan, Miller & Ceresi L.L.P.; Baltimore CPA Joel Cohn, a co-managing principal, Reznick Group; Cleveland, OH attorney Mary Forbes Lovett, partner, Cowden, Humphrey, Nagorney & Lovett Co., LPA; appraiser Michael Ehrmann, MAI, vice president, Jefferson & Lee Appraisals, Inc., Pittsburgh, PA; and Steve McClain, president, National Architectural Trust, Washington, DC.

Definition, Types of Easements

An easement is a partial interest and set of legal rights in a property (e.g., historic building) conveyed by the owner to another party. It generally includes restrictions on the future use of and physical alterations to the portion of property covered by the easement.

Federal tax laws and IRS regulations permit corporate or individual taxpayers to claim a tax deduction on their federal income tax return, as a charitable contribution, for an easement donation. But certain requirements must be met, including that the easement restrictions last in perpetuity.

Federal tax deductions are permitted for donations of qualified "conservation" easements, which include easements to preserve farmland, open space, historic

buildings, etc. A type of conservation easement is so-called historic preservation easements, which are easements on certified historic buildings. The latter can be any type of historic building (e.g., commercial, industrial), including owner-occupied homes.

Preservation easement donations for historic buildings can be done alone or paired with use of the federal historic rehabilitation tax credit.

Preservation easement donations to date have been more frequent for historic homes than commercial buildings, and most common – for various reasons – in Cleveland, New Orleans, Chicago, Los Angeles, Detroit, Cincinnati, Philadelphia, Washington, DC, San Francisco, and New York City.

Strengthened Requirements

The new legislative reforms strengthened some existing federal requirements for preservation easements for all types of certified historic buildings. These include to:

- Require appraisals for easement donations to be performed by a "qualified appraiser," which includes certain minimum qualifications.
- Reduce the thresholds that trigger penalties for inflated appraised values and donor tax deductions.

The new law also included some special rules for preservation easement donations technically applicable just to certified historic buildings located in "registered historic districts" (i.e. "contributing" buildings), and not also to historic buildings individually listed on the National Register of Historic Places. A National Trust memo on the new reforms, though, suggests donors and preservation groups "would be well advised" to follow the "common-sense guidance" reflected in the special rules for easements for certified historic buildings generally.

The special rules, which have various effective dates (the earliest for donations after 7/25/06), require that:

- A preservation easement include restrictions to preserve the "entire exterior" of the building, including

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the front, sides, rear, and area above the building. In addition, it must bar any changes to any part of the building's exterior inconsistent with the historical character of the exterior. In the past, "facade" easements, covering a smaller building of a building's exterior, such as just the front, were common.

- The donor (i.e. taxpayer) submit with their income tax return claiming the deduction more extensive documentation to substantiate the easement donation and its value, including a "qualified appraisal," photos of the entire building exterior, and descriptions of all current restrictions on development of the building. In addition, the easement donor and

recipient must enter into a written agreement that certifies the latter is a qualified easement holding organization able and committed to perpetually manage and enforce the easement's restrictions.

- The easement donation tax deduction be reduced if the taxpayer has claimed the federal historic rehabilitation tax credit on the same building in the past five years.

The new law also in general raises the annual deduction limit and lengthens the deduction "carry-forward period" for easement donations made in 2006 and 2007.

Appraisals, EHOs

The appraised value of a preservation easement donation in all cases will reflect the appraiser's estimate of the dollar loss in fair

market value to the existing historic building due to the easement and its restrictions. Ehrmann said he does this by finding "matched pair sales" of similar properties, with and without easements, to identify a loss factor due to the easement.

In some situations, however, Ehrmann indicated he will develop an appraised value for a preservation easement donation that reflects not only the appraised loss in value to the existing historic building, but also the estimated loss ("net residual profit") from foregone potential additional development at the building site (usually an addition atop the existing building). This "lost development" occurs in situations where, based on the facts and his judgment, the existing building hasn't been "built out" to its full development potential allowed under current local zoning and other restrictions (e.g. building height limits), but where an addition is permissible, physically possible, and economically viable given local market conditions.

Ehrmann noted his appraisal valuation methodology in these cases utilizes the services of an architect, engineer, and contractor.

In addition to a qualified appraiser, building owners and developers must find a qualified easement-holding organization (EHO) to receive their preservation easement donation. EHOs are tax-exempt entities that vary in the type and location of easements they hold. Some have national holdings; others just regional, state, or local. Examples of EHOs that hold preservation easements include the National Trust for Historic Preservation, National Architectural Trust



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(NAT), Landmarks Illinois, and L'Enfant Trust (Washington, DC). NAT's McClain advised owners and developers to look for an EHO that has an adequate "stewardship fund" to assure effective future monitoring of its easements, and that has a program for annual monitoring reviews of buildings.

'Monetizing' the Deduction

Owners and developers can benefit personally from a preservation easement donation by claiming a federal income tax deduction. Some, though, have chosen instead to "monetize" the value of the tax deduction to obtain extra cash from an investor that can utilize the deduction. Often the transactions doing this have also involved use of the federal historic tax credit to rehabilitate the building.

"If anybody is thinking of doing a tax credit project, they should be thinking of doing an easement as well," says Washington, DC attorney Nettler, who structures preservation easement donations.

But Nettler said easement donation deductions can't be syndicated the same way as tax credits. Instead, he said the tax deduction must be allocated under a structure to an investor that is a "real investor in the ownership entity of the property," and that has opportunity for other income generated by the property and some potential liability. "Their liability may be significantly different from the existing investors," he noted.

Timing also matters. Nettler said that to avoid potential recap-

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ture of historic credit, a preservation easement should be placed on the building either before the historic rehabilitation is placed in service, or after the five-year historic credit recapture period.

At present there are but a small number of investors willing to pay for preservation easement donation tax deductions. Ehrmann estimated only 25-30 large development deals so far, mostly in Cleveland, where this has occurred. But he added efforts are underway "to create a more solid investment base for easements."

Lovett said her firm has structured preservation easement transactions, primarily on Cleveland buildings and also utilizing the historic credit, in which a C corporation has typically been the 99 percent limited

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efforts, for client syndicators. He noted the biggest reasons for the failed repositionings he has seen have been, first, doing too little rehab work, and secondly, poor management. "In a light rehab," Ross said, "even if they're replacing cabinets, resurfacing things, and putting in all new appliances, in the end, the 1970s apartment is still a 1970s apartment. It's not going to compete with a property built in the 1990s and the 2000s." Successes, he indicated, are cases where after a gut or substantial rehabilitation is completed, "you have a property that looks brand new... You're fixing everything that possibly needs to be fixed." ■

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As of January 1, 2006, The Enterprise Foundation became Enterprise Community Partners, Inc., and The Enterprise Social Investment Corporation became Enterprise Community Investment, Inc.

New Markets Tax Credit

New GAO Report Provides Data on NMTC Investors, Motivations

A NEW REPORT ON THE NEW MARKETS TAX CREDIT (NMTC) program by the Government Accountability Office (GAO) recommends additional compliance steps and provides a wealth of new information and statistics on NMTC investment levels and trends, investor motivations, data collection and compliance activities, the volume and geographic distribution of allocations and funded projects, and other areas.

Authorized in 2000, the NMTC is a federal income tax credit designed to spur investment in businesses located in low-income communities. Special organizations called community development entities (CDEs) compete in funding rounds for allocations of NMTC investment authority. CDEs that win allocations raise capital from investors and deploy it in eligible projects and activities in low-income communities. The program is administered jointly by the Community Development Financial Institutions (CDFI) Fund and the IRS.

Compliance Recommendations

The new report describes the status of the NMTC program; profiles NMTC program participants; assesses the credit and its effectiveness in attracting investment by participating investors; and assesses IRS and CDFI Fund compliance monitoring efforts.

Its only recommendations are that the IRS:

- Develop information for selecting which CDEs to audit as part of its current compliance study, to ensure it is reviewing the full range of NMTC transactions; and,
- Work with the CDFI Fund to explore further options for cost-effective monitoring of investor compliance.

The report notes the IRS is now auditing 20 of the 66 CDEs that received NMTC allocations in the first funding round, and plans to audit 15-25 CDE allocatees from each funding round. It also says the CDFI Fund has hired a contractor to design by mid-2007 a comprehensive study to evaluate the NMTC program.

According to the report, as of January 2007, the CDFI Fund through four funding rounds had made 233 awards of \$12.1 billion in NMTC allocation authority to 179 CDEs. These CDEs so far had raised nearly \$5.3 billion in capital from investors (nearly 1,400 “qualified equity investments,” or QEIs), and will be raising additional capital from investors in coming years to use up the remaining \$6.8 billion in allocation authority.

GAO,

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Group Developing Recommendations for Documentation

AN INDUSTRY working group is developing recommendations for community development entities (CDEs) on how to document compliance with the targeted population requirements of the federal new markets tax credit (NMTC) program.

The project is just one of the tasks that the group has undertaken to help CDEs better understand the program’s requirements and carry out their activities. “We’re very much focused on the operational, day-to-day issues that CDEs face in complying with the program,” CPA Michael Novogradac told the *Tax Credit Advisor* in an interview. Novogradac is managing partner in the San Francisco, CA office of Novogradac & Company LLP, a national accounting and consulting firm that coordinates and provides staff support for the working group.

Novogradac said the working group was formed after the first round of NMTC allocations, has representatives of 15-20 active CDEs, and meets monthly by conference call or in person.

CDEs raise capital from NMTC investors and must deploy it in qualified businesses or other eligible activities in low-income communities.

Last year, the IRS issued Notice 2006-60 to announce it would be issuing regulations to implement the

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GAO,*continued from page 25*

As part of its study, GAO examined and analyzed data from the CDFI fund, tax returns for NMTC investors for tax years 1997–2004, and results of a survey it did of all NMTC investors to date that produced a 51 percent response rate.

GAO's study distinguished between NMTC investors that are individual investors and NMTC investors that are corporate investors (e.g., corporations, banks), and compared the activities of NMTC investors to sample groups of taxpayers (corporate, individual) that weren't NMTC investors.

The study reports that total investment appears to have risen in low-income communities since the creation of the NMTC. "The results of GAO's survey and statistical analysis," it says, "indicate that the NMTC may be increasing investment in low-income communities by participating investors. Investors indicated that they have increased their investment budgets in low-income communities as a result of the credit, and GAO's analysis indicates that businesses may be shifting investment funds from other types of assets to invest in the NMTC, while individual investors may be using at least some new funds to invest in the NMTC." It adds: "We infer that the most likely effect of the credit is that corporate investors, which make the majority of investments in CDEs, are shifting investment into low-income communities from higher-income communities."

Other study findings include that:

- Banks and individuals combined comprise about 70% of all NMTC investors by number, but the largest share of NMTC investments by total dollar amount has been by bank and corporate investors.
- Surveyed NMTC investors gave various reasons for participating in the NMTC program. The most popular: to obtain the tax credit (76.7% identified as a "very great to moderate" reason); to obtain a return on their investment (82.1%); to improve conditions in low-income communities (90.1%); and to create or retain jobs (77.8%).
- NMTC investors are wealthier than non-NMTC investors. For tax year 2003, average asset size was \$98.3 billion for NMTC corporate investors compared to \$9.9 billion for all corporate taxpayers. Average annual adjusted gross income was about \$1.2 billion for NMTC individual investors; \$47,600 for all individual taxpayers.
- The expected rate of return has declined from 8.2% on NMTC investments made in 2003 to 6.8% for later investments.
- NMTC investments had been made, through FY 2005, in 583 projects in 45 states, the District of Columbia, and Puerto Rico. Top 10 states by total dollar amount of loans and investments, in order: CA, NY, OH, ME, WI, MO, MA, KY, NC, and WA.

(The report, "New Markets Tax Credit Appears to Increase Investment by Investors in Low-Income Communities, but Opportunities Exist to Better Monitor Compliance," is available at <http://www.gao.gov>) ■

Easements,*continued from page 22*

partner investor allocated 99 percent of the charitable tax deduction.

But she noted the current Cleveland market for new preservation easement transactions has "sort of dried up," as local investors await the outcome of a number of pending IRS audits of past local easement donations.

In March 2006, an IRS official in a speech said that the Service was examining a number of past easement donations nationally.

Others interviewed by *TCA*, though, indicated they continue to see new preservation easement donations. ■

ADDITIONAL INFORMATION**National Trust for Historic Preservation**

<http://www.nationaltrust.org/legal/easements/index.html>

IRS

<http://www.irs.gov/charities/article/0,,id=137244,00.html>

National Park Service

<http://www.cr.nps.gov/hps/tps/tax/easement.htm>

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Washington and State Update

CAPITAL BRIEFS

IRS Grants Exceptions for LIHTC, NMTC

New IRS Revenue Procedure 2007-20 provides certain exceptions for the federal low-income housing and new markets tax credits (LIHTC, NMTC), but not the historic tax credit, under new restrictions that impose federal excise taxes and disclosure requirements on tax-exempt entities that participate in prohibited tax shelters. Prohibited tax shelters include “reportable” transactions, a subset of which is transactions that provide “contractual protection.”

Rev. Proc. 2007-20 indicates the presence of refundable or contingent fees related to the LIHTC or NMTC will be disregarded in a transaction in determining if it is a transaction with contractual protection.

(Text: <http://www.irs.gov/pub/irs-drop/>)

Historic Credit Bills Introduced in Congress

Bipartisan bills (H.R. 1043, S. 584) that would make sweeping improvements to the federal historic rehabilitation tax credit were introduced 2/15/07 in the House and Senate.

The Community Restoration and Rehabilitation Act, similar to legislation introduced in the 109th Congress, includes proposed amendments to foster greater use of the historic credit for smaller commercial projects and Main Street program commercial properties located in older neighborhoods, and to permit more favorable pairing of it with the federal low-income housing tax credit.

(Text: <http://thomas.loc.gov>)

IRS Memos Opine Against State Credit Deals

The IRS on 1/26/07 released two Office of General Counsel (OGC) memos (Nos. 200704028, 200704030) taking issue with the tax structure and intended tax benefits for investors in certain transactions that utilized state income tax credits for rehabilitation expenses. In the transactions, individual investors acquired small interests in partnerships, and sold back their interests within months to the promoters under repurchase options. In exchange for providing cash, the investors were to receive allocations of a share of the state tax credits, and claim federal deductions for tax losses.

The OGC memos assert the investors weren't truly partners in a partnership under the “substance over form” doctrine, and that the transactions should be recast as a disguised sale of partnership property, with the tax losses to investors disallowed.

(Text: <http://www.irs.gov/foia/lists/0,,id=97705,00.html>) ■

State Briefs

Ohio Enacts New State Historic Tax Credit

Ohio Gov. Bob Taft recently signed into law a bill (HB 149) establishing a state historic rehabilitation tax credit.

The new law authorizes a 25 percent refundable tax credit on qualified rehabilitation expenditures for eligible projects. The new program, which will provide certificates, is to begin 7/1/07 and feature an initial two-year pilot phase in which 100 projects per year will be considered.

The Ohio Department of Development is to develop rules for the program and will oversee it in conjunction with the state Department of Taxation.

Ohio is the 29th state to establish its own historic tax credit.

(Text of law: http://www.legislature.state.oh.us/bills.cfm?ID=126_HB_149)

California Sets Application Deadlines

The California Tax Credit Allocation Committee has announced its schedule for its 2007 low-income housing tax credit program.

Planned application deadlines are 3/22/07 for the first funding round and 7/12/07 for the second funding round.

Details and CTCAC's program rules for 2007 are available at <http://www.treasurer.ca.gov/ctcac>.

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new targeted population statutory provisions, and to provide initial guidance. Under these provisions, CDEs can fund qualified businesses not located in a low-income community if: (1) one-half the business's total income comes from low-income individuals; (2) at least 40 percent of the business's employees are low-income individuals; or (3) at least half the business is owned by low-income individuals.

Novogradac noted the working group is developing a set of "recommended practices" intended to guide CDEs on what to do to document compliance with the targeted population requirements. He noted: "We are developing a series of documents and recom-

mended procedures that say, 'This is how you can go through and document that you're complying with this rule.'"

Novogradac, when interviewed 2/1/07, said working group members were reviewing an initial draft. He expected it to be made public in about a month for solicitation of additional comments. A June vote on adoption is expected.

Novogradac said the public draft will be posted, as are past working group documents, at <http://www.novoco.com> (New Markets Tax Credit section). Novogradac said the working

group since its inception has completed a long list of projects, including comments on and suggested improvements to the NMTC allocation agreement and application, comments on program rules, and obtaining or requesting clarification on various program requirements and terms affecting CDEs. He said the working group doesn't get involved in legislative or policy issues.

Novogradac said the working group is open to other CDEs. CDE officials interested in joining should contact Michael Novogradac (415-356-8000) or Atlanta principal Brad Elphick (678-867-2333). ■

Monthly LIHTC, AFR Rates

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