Housing – Momentum West

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2019

Today's Agenda

- Multifamily
- Single Family
- Opportunity Zones
- Q & A

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Housing Tax Credits
Multifamily Financing
Economic Development
Single Family

Housing Tax Credits (IRC Section 42)

- Created in 1986 within Section 42 of the Internal Revenue Code
- Designed to encourage private investment in affordable rental housing
  - The HUD Section 8 program stopped creating new affordable units in the early-1980s
- The tax credit is a dollar for dollar offset to federal tax liability
  - Generally, credit is received over 10 year period, but affordability extends for 30 years
- Good example of successful public-private partnership

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Types of Housing Tax Credits

- Federal 9% (a/k/a “competitive”)
  - Wisconsin’s federal allocation is approximately $15.5 million per year
  - Scarce resource – very competitive
    - Demand typically exceeds supply by 2:1 in Wisconsin
    - Had been as high as 4:1 earlier in the decade
  - One allocation cycle per year

- Federal 4% (a/k/a “non-competitive”)
  - Tied to state’s tax-exempt bond volume cap
  - Year-round allocation cycle

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Types of Housing Tax Credits

- On March 28, 2018, Wisconsin 2017 Act 176 was passed, which created the Wisconsin Housing Tax Credit (HTC) program.
- The State Housing Tax Credit was designed to be a complement to the federal 4% Low Income Housing Tax Credit, and follows the vast majority of rules that are currently in place for the federal tax credit program
- $7 million of state HTCs available each year
- 4% State Housing Tax Credits are awarded competitively, through a once-per-year cycle coinciding with the 9% application round

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Housing Tax Credit Requirements

- Applications must meet a series of threshold tests before scores are assigned
  - Including financial feasibility, minimum design requirements, evidence of acceptable market for the property, etc.

- Those meeting the thresholds are scored against other similar applications in their 'set-aside' (category)
    - Non-Profit
    - Supportive Housing
    - Rural
    - Preservation
    - General

Housing Tax Credit Requirements

- Properties receiving HTCs must agree to set-aside a minimum of:
  - 20% of units for households at/below 50% of County Median Income (CMI)
  - 40% of units for households at/below 60% of CMI
  - 40% of units for households at an average CMI of 60% or less

- In reality, the competitive nature of the 9% HTC program results in properties that set-aside a far higher percentage of units for low-income households, with rents well below 60% of CMI, than is mandated by Section 42
  - Typically, more than half of units set-aside for households at/below 50% of CMI – with ~15-20% set-aside for 30% CMI households
  - Contrast with tax-exempt bonds…

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Housing Tax Credit Requirements

Housing Tax Credits
And Multifamily Financing

Effective April 2019 MTSP
Income Limits
(60%)

1 – Person = $28,740
2 – Person = $32,880
3 – Person = $36,960

https://www.wheda.com/WorkArea/DownloadAsset.aspx?id=2509

– Adams, Ashland, Barron, Bayfield, Buffalo, Burnett, Clark, Crawford, Florence, Forest, Iron, Jackson, Juneau, Langlade, Marinette, Marquette, Menominee, Oneida, Price, Richland, Rusk, Sawyer, Shawano, Taylor, Vernon, Vilas, Washburn, Waushara

Housing Tax Credit Requirements

Preschool Teacher	$26,400
Home Health Worker	$25,300
Childcare Worker	$22,300
Farmworkers	$26,100
Hairdressers	$28,040
Janitors & Cleaners	$27,160
Security Guards	$28,230
Pharmacy Aides	$23,090

Housing Tax Credits: How Do They Work?

- HTC allocations are ‘sold’ to an investor through the creation of an LLC or LLP with the developer
  - The developer typically acts as the Managing Member
  - Investor receives the tax benefits of the HTCs
- The equity generated from the sale of HTCs allows the developer to build the property with a significantly lower-than-normal debt load
  - HTC equity may represent as much as 60-65% of the total development budget
- The reduced debt service allows the developer to rent units at below-market rental rates that are affordable to low-income families and seniors

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Housing Tax Credits: How Do They Work?

- As most units in a 9% HTC property are set-aside for households below 60% of CMI, the properties generate limited amounts of income and cash flow from operations

- So, developer fees are the primary economic motivation for HTC developers
  - Developer fees are typically 10-12% of the total budget
  - Fees are typically collected from closing through stabilization
    - Negotiated with the tax credit syndicator/investor
  - A portion of developer fees (25-40%) are often deferred, and repaid from future property cash flows

Housing Tax Credits: What does it look like?

Housing Tax Credits and Multifamily Financing Example

Sources of Proceeds			Use of Proceeds	
WHEDA Loan #1	$6,725,700.00		Aqcuisition Building/Land	$2,210,000.00
WHEDA Capital Magnet Fund	$125,000.00		Construction Hard Costs	$21,395,357.00
Preservation Alliance	$5,286,034.00		Soft Costs	$8,673,328.00
Cash	$100.00		Lease-up Operating Deficit	$29,500.00
LIHTC Equity	$9,290,853.00		Operating Reserve	$533,929.00
Deferred Developer Fee	$2,512,204.00			
State Housing Tax Credit Equity	$3,937,440.00			
Federal Historic Equity	$4,964,783.00			
Total Sources	**$32,842,114.00**		**Total Uses**	**$32,842,114.00**

Housing Tax Credits: How Do They Work?

- STEP 1: ELIGIBLE BASIS.
  - This is the total amount of development cost that would be eligible for generating Section 42 tax credits if all of the housing units are used for low-income housing.
- STEP 2: APPLICABLE FRACTION and QUALIFIED BASIS.
  - This is calculated by the units set aside as affordable units.
- STEP 3: APPLICABLE PERCENTAGE
  - This is a federally calculated number based on the tax credit being applied for.

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Housing Tax Credits: WHEDA's role

- Create the Qualified Allocation Plan (QAP)
  - Typically, we create a two-year QAP
  - Requires approval by WHEDA's Board and the Governor
- Allocate Tax Credits
  - Approximately $15.5 million per year of 9% Federal HTCs and $7 million of State 4% HTCs, along with non-competitive 4% Federal HTCs
- Monitor developments for compliance
  - Report violations to IRS and Wisconsin Dept. of Revenue

Housing Tax Credits: Investors

- Investors typically participate through a direct-investment model, or by investing in funds organized by HTC Syndicators
  - The funds may have specific preferences such as geography, project size, target population, etc…
- Financial institutions are the primary investors in HTC properties
  - Community Reinvestment Act obligations are a key motivator of HTC investment activity
  - The top 10 corporate investors account for approximately one-half of HTC investment activity

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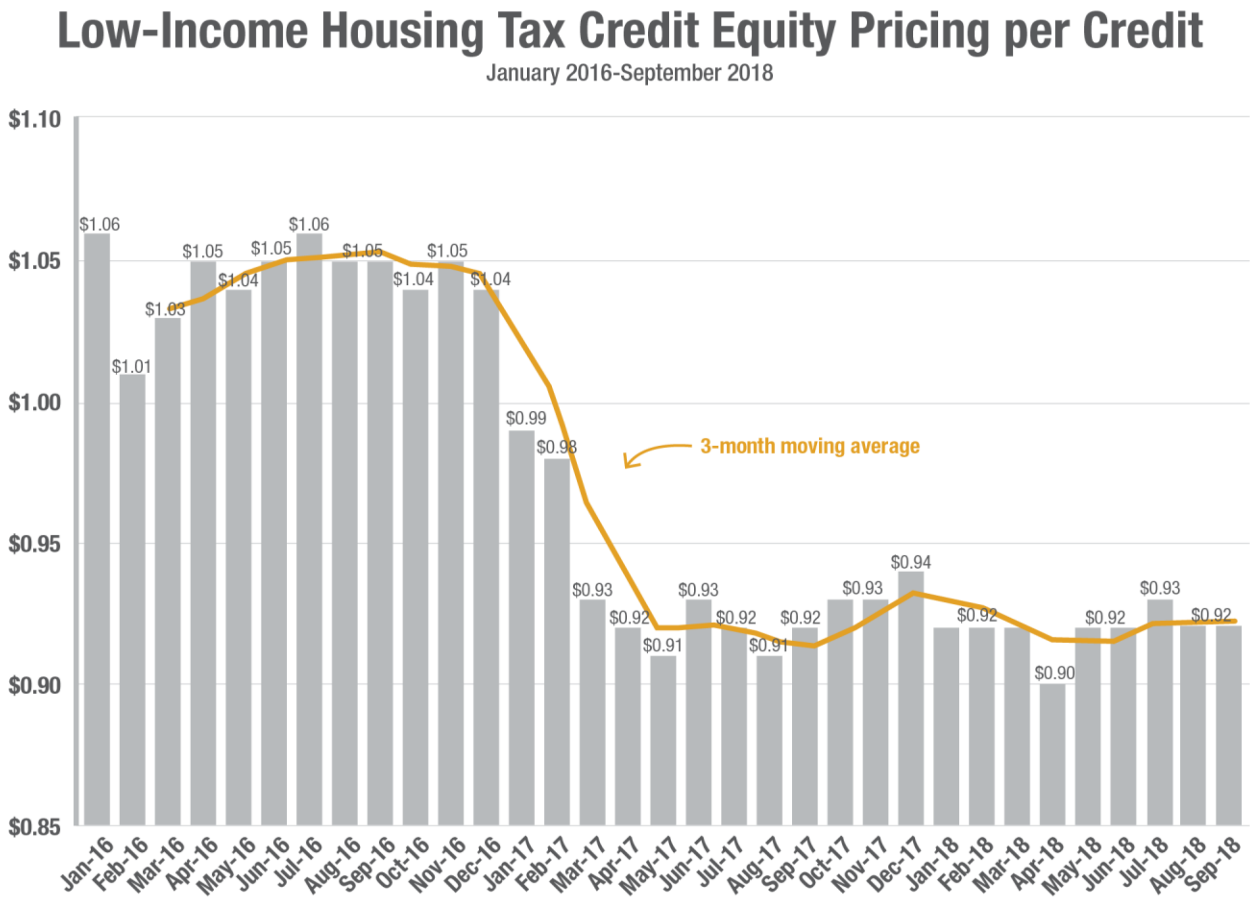
Housing Tax Credits: Pricing



This low-income housing tax credit equity pricing chart is presented for general information purposes only. Per credit equity pricing is based on syndicator Letter of Intents (LOIs) provided to Novogradac & Company LLP by market participants. The equity price reported for each month is the average equity price for LOIs issued in that month. No adjustments to equity pricing are made for timing of capital contributions or other considerations. Data labels are rounded to the nearest cent.

Source: Novogradac & Company LLP

NOVOGRADAC & COMPANY LLP

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Current Issue: Development Risks

- In simple terms - HTC transactions are difficult to assemble

- In the summer of 2016, WHEDA closed a 4% HTC transaction with 11 capital sources – a 2017 4% transaction had 13 capital sources

- Even in a lucrative HTC pricing environment - low rents for affordable units, combined with increasing construction costs and interest rates, requires that the typical HTC transaction secure multiple loans/grants (in addition to a traditional, long-term permanent loan)
  - Other sources include TIF, FHLB Affordable Housing Program, local housing trust funds, HOME, historic tax credits, etc.

Current Issue: Development Risks

- Pre-development
  - It costs $25,000 or more to assemble a 9% HTC application for WHEDA to review – with the odds of success typically less than 50%
  - HTC properties have a long development window
    - The time from site selection – to HTC award – to closing – to construction completion can be more than three years
    - Some sellers are hesitant to tie-up a piece of land for properties with a long closing horizon

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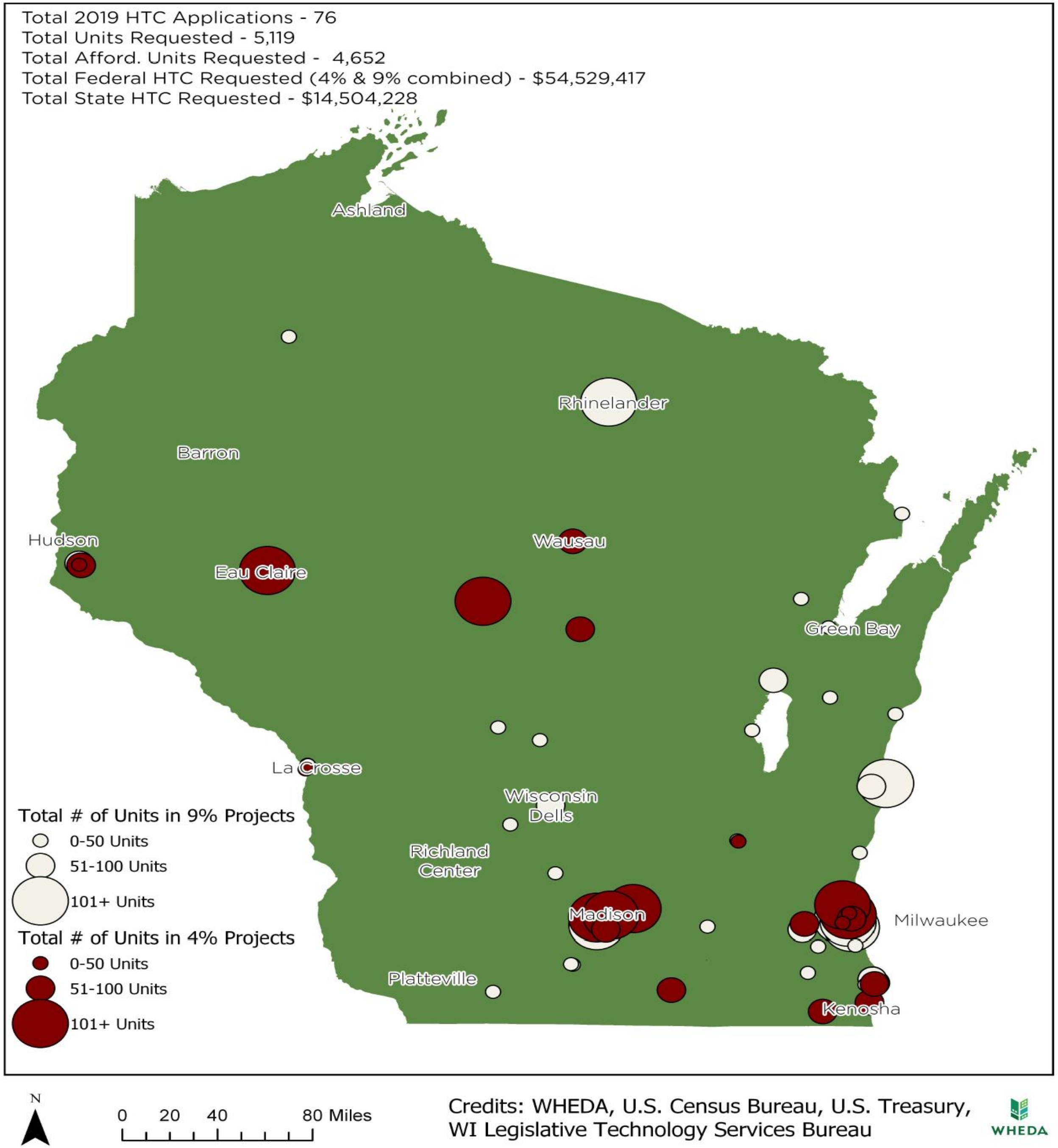
Total 2019 HTC Applications - 76
Total Units Requested - 5,119
Total Afford. Units Requested - 4,652
Total Federal HTC Requested (4% & 9% combined) - $54,529,417
Total State HTC Requested - $14,504,228
Ashland
Rhinelander
Barron
Hudson
Wausau
Eau Claire
Green Bay
La Crosse
Wisconsin Dells
Richland Center
Madison
Milwaukee
Platteville
Kenosha
Total # of Units in 9% Projects
0-50 Units
51-100 Units
101+ Units
Total # of Units in 4% Projects
0-50 Units
51-100 Units
101+ Units
N
0 20 40 80 Miles
Credits: WHEDA, U.S. Census Bureau, U.S. Treasury, WI Legislative Technology Services Bureau
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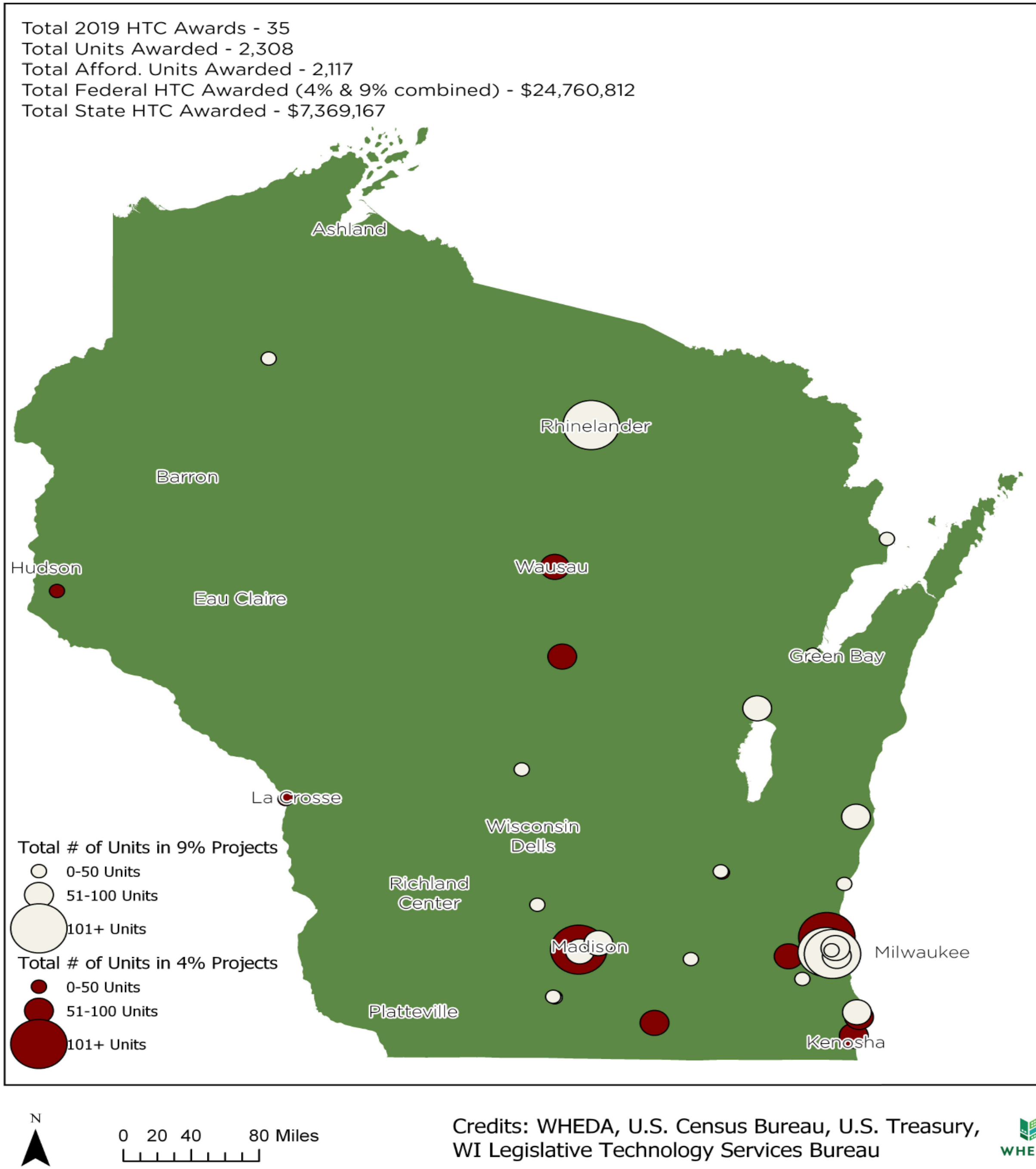
WHEDA Federal & State Housing Tax Credit Awards, 2019 Cycle



Credits: WHEDA, U.S. Census Bureau, U.S. Treasury, WI Legislative Technology Services Bureau

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Housing Tax Credits: Role of TIFs

- Tax Incremental Financing (TIF) is becoming more common in HTC transactions

- However, the structure of TIFs has evolved in recent years
  - In the past, TIFs were typically funded with municipal borrowing
    - Municipal debt was repaid by the incremental increase in property taxes
  - Now, the developer-financed structure is much more common
    - In that structure, a portion of annual property tax increment is returned to the owner, who then uses those returned taxes to pay debt service on a TIF loan from a financial institution

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Tax-Exempt Bonds

- Pre-dates the Housing Tax Credit program
- Loans funded with tax-exempt bonds make-up the majority of WHEDA's $800+MM multifamily portfolio
- Properties using bonds often utilize the non-competitive, 4% federal HTC program
  - May be a good option for acquisition/rehab transactions
  - May not be a good option for new-construction (outside of high-rent areas)

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Tax Exempt Bond Financing

- “Pooled” bond issue or “Stand Alone” bond issue
- Minimum DCRs of 1.10 to 1.20
- LTV: 85% to 90%
- 30 year term & amortization are typical.
  - May agree to longer term & amortization for new construction

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Tax-Exempt Bonds

- In brief…
  - WHEDA issues tax-exempt bonds
  - WHEDA then uses the bond proceeds to provide below-market loans to multifamily developers
  - In exchange for the below-market loan, the developer agrees to set-aside some units at affordable rental rates:
    - 20% of units at 50% CMI, or
    - 40% of units at 60% CMI

Single Family Update

- GSE Adjustments

  What does that mean for WHEDA and our partners?

- Down Payment Assistance

Details forthcoming

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Opportunity Zones

HELPING MUNICIPALITIES ACTIVATE OPPORTUNITY ZONES

120 WISCONSIN OPPORTUNITY ZONES were designated in 2018, but there hasn't been much help for local governments and regional economic development agencies to catalyze investment in the vast majority of Opportunity Zones across the state. Meanwhile, investors who do not make qualified Opportunity Zones investments by the December 31, 2019 deadline will not receive the maximum tax-favorable treatment available under the federal tax code. *The City of Racine has formed a public-private partnership with a financial institution to make Opportunity Zones investment easier for its three zones, and will make its services available to other Wisconsin communities.* The public-private partnership and how other communities can participate will be unveiled as part of the September 11-12, 2019 Racine Smart Cities September Conference. For more information about participating, please contact William Martin, Racine's Chief Innovation Officer, at William.Martin@CityofRacine.org , or register to participate at www.RacineSmartCity.com.

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LEAGUE OF WISCONSIN MUNICIPALITIES

Looking for More Information

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