

How to Save Your Property's 9 Percent Rate (Even with 2014 Credits)

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December 30, 2013! Without Congressional action, this is the last day a building using low-income housing tax credits (LIHTCs) can be placed in service and benefit from a 9 percent applicable percentage. In light of this looming date, this article discusses techniques that some projects may be able to use to either preserve the 9 percent rate or otherwise utilize the full amount of LIHTCs they have been awarded, including cases where the 9 percent rate can be used with 2014 LIHTCs.

Background

The applicable percentage is the rate that one multiplies against a building's qualified basis in order to determine the maximum amount of LIHTC that a building can receive. Until 2008, the applicable percentage for a building not using tax-exempt bonds was determined based on the earlier of the month the building was placed in service or the month in which the owner and the credit agency entered into a binding agreement as to the LIHTC amount to be allocated to a building.

Amid the financial meltdown in 2008, Congress passed the Housing and Economic Recovery Act of 2008 (HERA), which included many improvements to Internal Revenue Code (IRC) Section 42. HERA specifically established that for new construction or rehabilitated buildings financed without tax-exempt bonds that are placed in service after July 30, 2008 and before Dec. 31, 2013, the applicable percentage will be no less than 9 percent (the 9 percent floor).

The creation of the 9 percent floor had an immediate helpful

impact on the financing of LIHTC buildings. The 9 percent floor was 13.5 percent higher than the July 2008 applicable percentage of 7.93 percent. This difference has continued to grow. In August, the 9 percent rate was 22 percent higher than the August 2012 floating rate. This allows projects to qualify for 22 percent more LIHTC and equity.

The Critical Issue is "Placement in Service"

The 9 percent floor is only available for buildings placed in service by Dec. 30, 2013. Being able to place buildings in service in time is becoming a critical issue for developers, investors and credit agencies. Before looking at strategies for preserving the 9 percent floor, it is important to understand three important points:

- ♦ Look at each building. The availability of the 9 percent floor is not determined on a project basis, but is determined separately for building.
- ♦ What does "placement in service" mean? Placement in service means that a property is ready for its intended use in a trade or business. For rental property this generally means that a building is ready for occupancy. Internal Revenue Service (IRS) Notice 88-116, Internal Revenue Bulletin (IRB) 1988-44 provides that a certificate of occupancy for at least one unit is prima facie evidence that an LIHTC building has been placed in service. A special rule for rehabilitated buildings is discussed later in this article.
- ♦ Don't be a day late. Buildings must be placed in service before Dec. 31, 2013. That means placing in service on Dec. 31, 2013 is too late. Dec. 30, 2013 is the last day to get a building in service.

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Strategies to Preserve the 9 Percent Floor for Allocations in 2013 or Earlier

Below are some strategies that can either preserve the 9 percent floor or allow a project to utilize all of its LIHTCs.

- ♦ Finish construction and lease the entire building. This is the most obvious strategy. If construction is completed and a certificate of occupancy is received no later than Dec. 30, 2013, then the 9 percent floor applies. If all the low-income units are rented by the end of 2013, the owner can even take 2013 LIHTCs and not worry about having unrented units that would receive two-thirds credits under Section 42(f)(3) for the remainder of the 15-year compliance period.
- ♦ Get a certificate of occupancy on one unit, but finish construction and lease-up in 2014. Because it is only necessary to place one unit in a building in service, it may be possible to get a certificate of occupancy for at least one unit by Dec. 30, 2013 and then complete construction and lease-up in 2014. The owner would then elect to start the first year of the 10-year credit period in 2014. Because a building's eligible basis and applicable fraction are determined at the end of the first year of the credit period, this will allow an owner an extra year to complete construction and rent all the low-income units. A building's eligible basis would be able to include all costs incurred by the end of 2014 for all the units rented by the end of 2014. Keep in mind that each building in a project would have to have at least one unit placed in service in order to get the 9 percent floor for all buildings. Also, it's worth noting that in addition to a certificate of occupancy, some investors are indicating a desire for a unit to be rented by Dec. 30, 2013.
- ♦ Consider the placement-in-service flexibility for rehabilitated buildings. Section 42(e) provides a special rule that a rehabilitated building is treated as placed in service at the end of any 24-month period picked by the owner in which rehabilitation expenditures exceed the greater of (i) 20 percent of the building's adjusted basis, or (ii) \$6,000 per unit (increased annually by an inflation factor—the amount for 2012 is \$6,200). Thus if a rehabilitated building meets this minimum rehabilitation requirement by Dec. 30, 2013, then the owner can elect to place the building in service during a month in 2013 even if the building does not have a certificate of occupancy. In this situation, one would also want to defer the start of the credit period to 2014 so that all costs incurred in 2014 can be included in eligible basis.
- ♦ Maximize LIHTCs for multiple building projects. Because the availability of the 9 percent floor is determined separately for each building, projects with multiple building carryover allocations may be able to use all their LIHTCs even if some buildings are placed in service in 2014. It is common that projects are not allocated the maximum amount of LIHTCs that the qualified basis could support. In such cases, it might be possible to use all the allocated LIHTCs even if some

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buildings are not placed in service by Dec. 30, 2013. Because most carryover allocations are made on a project basis under Section 42(h)(1)(F) rather than on a building by building basis, the owner can choose to allocate more LIHTCs to the buildings placed in service by Dec. 30, 2013 and less to the building placed in service in 2014. This would allow the entire amount of LIHTCs to be utilized even if one building does not qualify for the 9 percent floor. Owners should consider this approach even if they intend to place all of their buildings in service by Dec. 30, 2013. This way, the project can afford to have some buildings miss the date and still be eligible for the entire amount of LIHTCs.

As an example, assume a project consists of four identical buildings which each have a qualified basis of \$2.5 million, resulting in \$10 million of qualified basis for the entire project. Using the 9 percent floor, the project could support an allocation of up to \$900,000 of LIHTCs. However, because of the presence of other funding sources, the tax credit agency may have allocated a smaller amount, say \$800,000. As the chart below indicates, if three of the four buildings are placed in service by Dec. 30, 2013, then the entire \$800,000 of LIHTCs could still be utilized.

	Building1	Building2	Building3	Building4	Total
Placement in Service Date	October 1, 2013	November 1, 2013	December 1, 2013	January 1, 2014	
Qualified Basis	2,500,000	2,500,000	2,500,000	2,500,000	10,000,000
Applicable Fraction	9.00%	9.00%	9.00%	7.37%	
Maximum Credits	225,000	225,000	225,000	184,250	859,250

Using the 9 Percent Rate with 2014 LIHTCs – Get a Binding Commitment

In some cases, a credit allocating agency may not have 2012 or 2013 LIHTCs available, but could provide an allocation of 2014 LIHTCs. There is a method that could preserve the 9 percent floor for some projects if they receive a binding commitment for 2014 LIHTCs before the end of 2013.

Projects generally need to receive an allocation of LIHTCs no later than the year they are placed in service. However, Section 42(h)(1)(C) provides an exception “if there is a binding commitment (not later than the close of the calendar year in which the building is placed in service) by the housing credit agency to allocate a specified housing credit dollar amount to such building beginning in a specified later taxable year.” This means that a building placed in service in 2013 would still be eligible for 2014 LIHTC if it receives a binding commitment for 2014 LIHTCs before the end of 2013. The credit agency would then make the actual allocation of LIHTCs in 2014. The benefit is that even when using 2014 LIHTCs, if the building is placed in service by Dec. 30, 2013, then it would

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still qualify for the 9 percent floor. Note that the project would want to defer the start of the 10-year credit period to 2014 because one cannot claim credits before they are actually allocated.

This approach can be combined with some of the other approaches discussed above. For example, one unit in a building could be placed in service in 2013 and that building could receive a 2013 binding commitment for 2014 LIHTCs. Or a rehabilitated building could meet the minimum rehabilitation requirements in 2013 and get a 2013 binding commitment for 2014 credits.

One cautionary note: Section 42(h)(1)(C) requires that a building must be allocated a specified credit amount from a specified later taxable year. Based on the IRC's reference to a building rather than a project and based on informal discussions with IRS it appears that a binding commitment cannot be made on a projectwide basis under Section 42(h)(1)(F). Instead, each building must have an identified amount of LIHTC. It is, therefore, important to identify each building and the specific amount of 2014 credits that the building will receive.

Using the Discretionary Basis Boost for Projects that Place in Service Too Late

While the 9 percent credit is lost if a building is not placed in service by Dec. 30, 2013, it is possible for some projects to still be able to use their full credit allocation. In such a case, the credit agency could designate the project as eligible for the discretionary 130 percent basis boost in IRC 42(d)(5)(B)(v) that was created by HERA. If

the project was not already using the boost, then such a designation would allow the use of all credits. Credit allocating agencies can designate a project as qualifying for the 130 percent boost if the agency determines that the increase is necessary for a project's financial feasibility. For projects that had planned on using the 9 percent floor but missed the deadline, it should be easy for the credit allocating agency to determine that the project needs the basis boost. For some projects with tight timelines, investors are beginning to ask the state credit agency to confirm the availability of the 130 percent basis boost in the event the placement in service deadline is missed and the 9 percent credit is unavailable.

Conclusion

Meeting the Dec. 30, 2013 deadline is critically important for many LIHTC projects. However, with careful planning, owners can preserve the 9 percent rate for some projects, or at least find a way for a project to use its full allocation of credits. Meanwhile, the industry continues to work with Congress to extend the 9 percent rate. Hopefully congressional action will someday make this article obsolete. ❖

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