IMPROVING YOUR STATE CREDIT PRICING BY 14 CENTS: CERTIFICATED STATE CREDITS

California Tax Credit
Allocation Committee

Presenters

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- David Dologite and Richard Mandel, *California Housing Partnership*
- Aaron Mandel, *Meta Housing Corporation*
- Ari Beliak, *Bank of America Merrill Lynch*
- Todd Fabian, *National Equity Fund*
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Certificated State LIHTC

SB 837 of 2016 allows state low-income housing tax credits reserved in 2017-2019 to be “certificated.” This provision was authored by Senator Jim Beall and sponsored by Treasurer John Chiang and the California Housing Partnership Corporation.

The goal is to increase the pricing for state credits.

Allocated Credits

Historically, state LIHTC credits have been “allocated” to owners, and an investor had to have an ownership interest in the project to claim the credit.

With allocated credits, the reduction in the investor’s state tax liability reduced the investor’s federal deductions for state taxes and thereby increased the investor’s federal tax liability at the corporate tax rate.

Every dollar of allocated state LIHTC increases the investor’s federal tax liability generally by 21%. As a result, the natural price for state LIHTC credits is discounted by 21%.

Certificated Credits

Other states have figured out a way to avoid the impact of federal taxation on the state credits.

With “certificated” state LIHTC credits, the investor does not take an ownership interest in the project but buys the credits outright.

Breaking the ownership link changes the federal tax treatment of the state credit. Certificated credits do not reduce an investor’s federal deductions. Instead, they are a form of payment, like a gift card.

As a result, state credits are worth $1 to the investor.

Pricing Differential to Date

In 2017, the 11 certificated credits deals had average state credit pricing of $.87 versus an average of $.73 for the 12 allocated state credit deals, a $.14 difference.

In the first round of 2018, the 4 certificated credit deals had average state credit pricing of $.89 versus an average of $.76 for the 11 allocated credit deals, a $.13 cent difference.

In 2017, the higher pricing for certificated credits raised an additional $7 million in equity.

Comparison of Credit Value

	Allocated Credit	Certificated Credit
State Tax Credits Allocated:	$1,000,000	$0
State Tax Credit Certificated:	$0	$1,000,000
Reduction for Additional Federal Taxes Owed @ 21% MTR	($210,000)	($25,000)*
Effective Net Value of State Credit/Cert:	$790,000	$975,000
Investor Pay-in/Purchase Factor for $1.00 of State Credit or Certificate	$.76	$.90
Equity from State Credits/Certificates	**$760,000**	**$900,000**

*A small portion of state income taxes would not be deductible with certificated credits, based on the difference between the purchase price and 100c on the dollar.

Requirements for Certificated Credits

- Applicant must “irrevocably” elect traditional or certificated credits at application.

- The TCAC Director can approve a rescission of a certification election if the applicant is not able to obtain the statutory $.80 minimum price.

- TCAC will approve such rescissions if the applicant shows 3 bids wanting only allocated credits or offering prices of less than 80 cents for certificated credits. TCAC will also be flexible in considering other rescission requests, such as a single investor relationship.

Requirements for Certificated Credits

- For-profit and non-profit projects may apply, but the TCAC regulations require that a non-profit entity be the named applicant.
- The buyer of the certificated credits must be a taxpayer allowed the federal or state LIHTC credit for the taxable year of the purchase or any prior taxable year in connection with any project located in California.
- After the initial sale, certificated credits may only be sold one additional time.
- All sales must be reported to TCAC in 10 days of the final pay-in.
- The purchaser of certificated credit is NOT liable for CA LIHTC compliance. The partnership remains fully liable for compliance.

Structuring Sale: Applicant

- Certificated credits are transferable property.
- Selling the certificated credits is a taxable event.
- The nonprofit partner receives the certificated credits and does not have to pay income or capital gains taxes.
- Nonprofit partner sells certificated credits to the state investor.
- Nonprofit partner loans the sale proceeds to the partnership for the benefit of the project.
- Minimum interest rate on the loan will be subject to tax counsel approval.
- (Nonprofit partner will need to assign the federal LIHTCs to the partnership.)

Structuring Sale: Capital Account Issues

- Since certificated credit equity is not contributed as a capital contribution to the limited partnership by the purchaser, as is otherwise the case with allocated credit equity, the LP capital account does not include the state credit capital
- As a result, certificated credit projects may encounter deficit capital account issues, which can mean significant exit taxes as well as credit delivery problems.
- Negative capital accounts are more likely with 4%+State certificated projects, as the relative equity contribution is lower than 9%+State
- If the certificated credit loan is required to maintain AFR interest, the problem will be exacerbated.
- Capital account mitigation measures may be necessary, such as reduction in soft loan interest rates, reallocation of certain expenses to the GP, flipping of losses to the GP after the Federal credit delivery period, and/or disaffiliation of the GP. Additional mitigation measures include negotiating Year 12 exits in the Option agreement and/or elimination of taxes in the Option purchase price formula.

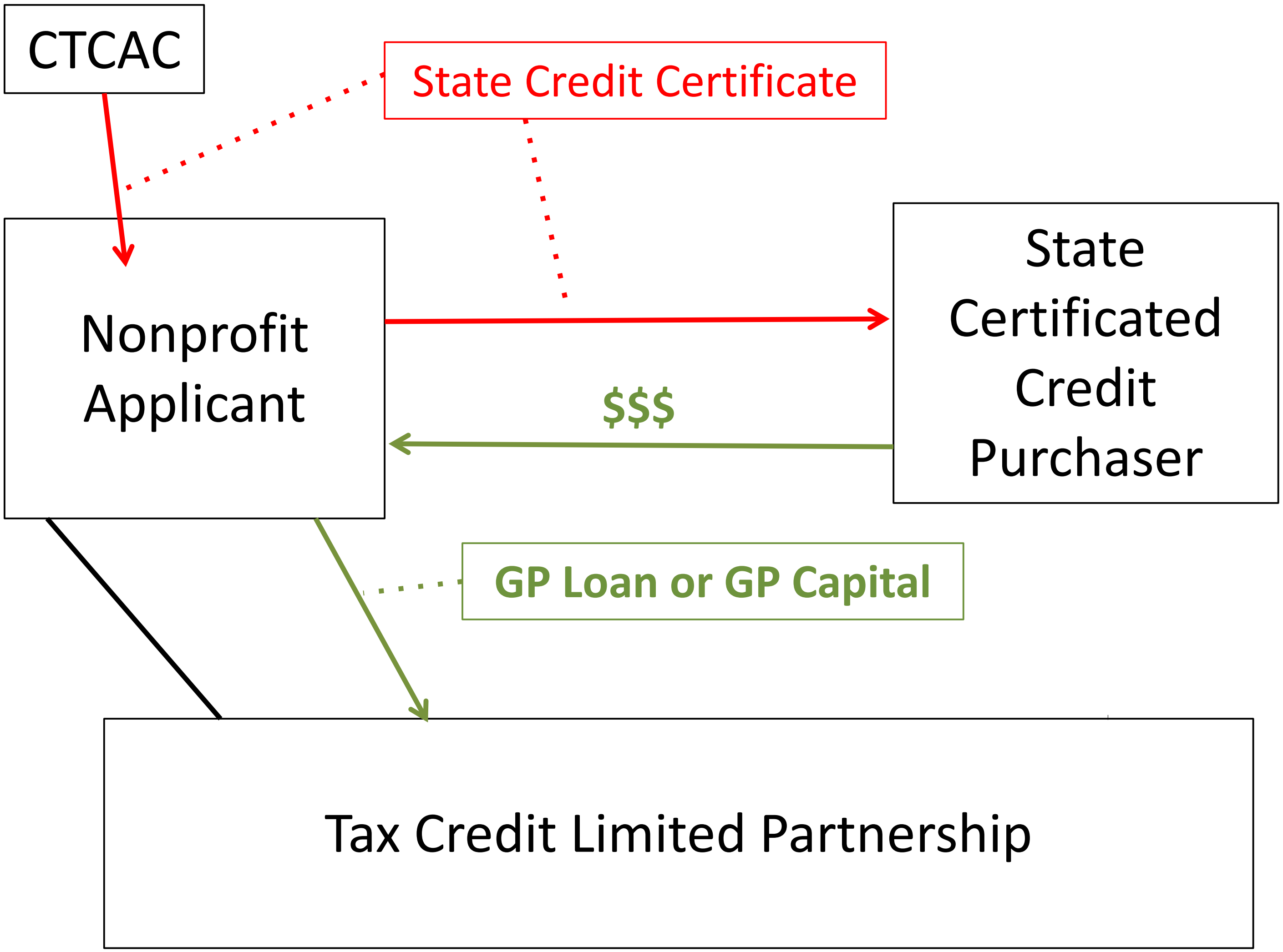
Special Issues for For-Profit Developers to Address

- May need to educate non-profit partner.
- Considerations for projects with back-end value.
- Case by case analysis factors.

Structuring Sale: Investor

- State Investor receives face value of credit.
- Investor pays tax on the difference between the face value of the credit and the price paid.
- Investor does not reduce federal income tax deduction for state income taxes paid.
- Investor may resell the credits once.

Certificated Credit Sale Structure



Investor Perspectives

- State of the market for certificated credits.
- Many investors are willing to buy both federal and state credits for a particular project.
- Pay-in schedules.
- Accounting issues.
- Ability to resell certificated credits.
- Indemnities.

Financial and Legal Considerations

- Non-profit capital contributions.
- Partner recourse debt.
- True debt test.

Questions and Answers