

Georgia Housing and Finance Authority Tax Credit Manual

This Manual is intended to be used as a basic resource for issues that arise regarding DCA's administration of the federal and state tax credit program for the State of Georgia. Due to the complexities of the Internal Revenue Code, the issuance of periodic private letter rulings and technical advisory memoranda issued by the Internal Revenue Services, DCA highly recommends that an accountant, tax counsel, or other tax credit professional be consulted on issues related to the allocation of tax credits, eligibility of all or a portion of certain soft costs, such as site development costs, developer fees, and construction financing costs, in the eligible basis, or other technical issues.

Overview

Federal Credit. The Low-Income Housing Tax Credit is made available under Section 42 of the Internal Revenue Code of 1986 as amended and offsets income taxes on a dollar for dollar basis. It is available to individuals (directly or through pass through entities such as partnerships and limited liability companies) and corporations that develop and own qualified low-income rental housing. Through the annual reduction of the taxpayer's ordinary income tax liability, the tax credit returns to the Owner/investor a percentage of the cost of constructing, acquiring and/or rehabilitating low-income rental housing. In contrast to other types of tax credits for other purposes, such as the Historic Rehabilitation Tax Credit, the Low-Income Housing Credit provides a tax credit **only** for expenditures associated with units which are occupied by low-income persons and not for the entire development (unless, of course, the entire development is reserved for low-income persons). An Owner who receives the credit must agree to rent a minimum number of units in each building to low income tenants at restricted rents.

State Credit. The Georgia Housing Tax Credit, enacted in 2000, is a credit against Georgia income tax liability and/or insurance premium tax liability to the Owner of an affordable housing development that has been allocated Federal low-income housing credits. The Department of Community Affairs, the Department of Revenue and the Office of the Insurance & Safety Fire Commissioner jointly administer the State Credits, which are in an amount equal to the Federal Credits and will be available to Owners of projects placed in service after January 1, 2001.

The annual State Credit dollar amount will equal that of the Federal Credit. The State Credit will be automatically allocated on a dollar-for-dollar basis with the Federal Credit (for both 9% and 4% Federal Credit) and will be available for the same time period.

2014 Georgia Credit Ceiling. The Georgia Housing and Finance Authority is charged with administering the allocation of Federal and State tax Credits in Georgia. The credit ceiling includes the following four components: per capita credit, unused credit, returned credit, and national pool credit assigned to Georgia. For the federal credit amount available for allocations during the competitive round, please refer to the current Qualified Allocation Plan as approved by the Governor.

For 2014, the LIHTC Manual and the Georgia QAP have been modified to reflect the changes required under HR 3221, The Housing and Economic Recovery Act of 2008 (HERA). The required changes are summarized below and notated in the manual for references. HERA became effective July 31, 2008.

- Eliminates the concept of “below market federal loans”.
- Allows state agencies to designate particular buildings for 130% basis increase treatment as if they were in difficult development areas.
- Provides that federal rental, operating, and interest reduction payments are not considered federal grants requiring a basis reduction.
- Provides that loans derived from federal grants do not require a basis reduction.
- Allows 50% related parties to qualify for acquisition credits (up from the former 10%).
- Eliminates the 10-year placed-in-service rule for projects financed or assisted pursuant to many federal or similar state programs.
- Specifically permits housing for special needs populations, housing for groups specified in federal or state housing programs, and artists’ housing to qualify for Housing Credits (provided fair housing rules are otherwise met).
- Allows a full one year to meet the “10% test” for carryover allocations; modifies the area median income computation for rural projects and HUD “Hold Harmless” projects.
- Increases the volume cap for tax-exempt housing bonds; and facilitates the use of refunding bonds for housing projects.

This is only a general summary; no action should be taken without a careful review of the specific provisions of HERA in the context of particular facts. In particular, the provisions have varying effective dates; whereas most rules apply to projects placed in service after the date of enactment, some are to be treated as if they have always been in the law, and some are effective for allocations made after 2008.

Applicable Credit Percentage. Federal tax credits allocated to a project cannot exceed the amount calculated by multiplying the qualified basis by the applicable credit percentage (ACP). When the low-income housing tax credit program started in 1987, the applicable percentage was 9 percent for new construction and rehabilitation and 4 percent for the acquisition of existing buildings and for all projects defined as Federally or subsidized, whether new constructions or rehabilitation.

The 9 percent and 4 percent credit percentages over a 10-year period were intended to equal to the present value of 70 percent and 30 percent, respectively, of the qualified basis. These percentages are adjusted monthly. However, the housing credit dollar amount allocated to a project cannot exceed the amount DCA determines is necessary for the financial feasibility of the project and its viability as a qualified low-income housing project throughout the credit period. **For underwriting purposes, in a 2014 application for 9% credits, the applicant should review the 2014 QAP for the Applicable Credit Percentage that should be utilized for new construction and/or rehabilitation. For purposes of a “4% credit” application with tax-exempt bond financing, the Applicable Credit Percentage for the month preceding the submission of the application for tax credits should be utilized.**

Credit Period. In general, the tax credit is claimed in equal amounts for a period of ten (10) taxable years, beginning with the taxable year in which the building is placed in service or, if elected by the Owner, the succeeding taxable year (the "Credit Period"). [Section 42 (f)]

If, after the first year of the credit period, there is an increase in the project's qualified basis, but no increase in the eligible basis, and there remains sufficient credit authority previously allocated by GHFA for such increase, the Owner may take the additional credit in an amount equal to two-thirds of the applicable percentage. This two-thirds credit is then taken over the remaining Compliance Period, rather than the remaining Credit Period. Credits should not be claimed prior to the issuance of IRS form 8609 by DCA.

Depending on the type of project, the federal credit will subsidize either 70% or 30% of the eligible cost of the low income units located in the project. With certain exceptions, Owners may receive annual Credits of the present value of 30% of the qualified basis for developments involving acquisition, and annual Credits of the present value of 70% of the qualified basis for developments involving new construction or rehabilitation.

Eligible Activities. There are three types of activities that are eligible for Federal and State Credits:

- A. New construction;
- B. Rehabilitation of an existing structure: meeting the greater of DCA's or the Federal minimum rehab expenditure requirements
- C. Acquisition of an existing structure: with rehabilitation costs which meet the requirements above

The conversion by the existing Owner of an existing building from a higher income to a low-income project without the minimum required rehabilitation DOES NOT qualify for tax credits.

Acquisition Credits. Projects that have not previously received a tax credit allocation are eligible for acquisition tax credits if the following statutory requirements are met at the time of allocation:

- The building(s) have been or will be acquired by purchase as defined in the Internal Revenue Code Section 179(d)(2) and
- Either the building(s) was last placed in service at least 10 years prior to the date of acquisition by the new development Owner, or a period of at least ten years has expired between the date of acquisition by the new development Owner; and the most recent non qualified substantial improvement of the building placed in service by the new development Owner or by any related persons specified in the Internal Revenue Code of 1986, as amended, Section 42(d)(2)(B) (iii).

HERA repeals the Housing Credit ten-year (anti-churning) rule for acquisition of Housing Credits for projects currently subsidized pursuant to certain specified HUD and USDA housing programs and similar state assisted programs, effective for buildings placed in service after date of enactment.

- Programs included are: HUD Section 8, Section 221(d)(3), Section 221(d)(4), Section 236, and USDA Section 515 and any other housing program administered by HUD or the Rural Housing Service of the Department of Agriculture.

Projects that have previously received a tax credit allocation and are applying for new credits are not eligible for acquisition credits unless the 15 year compliance period for all of the buildings in the project has expired.

Certain provisions of the law refer to "related persons with respect to the taxpayer" in determining whether a building qualifies for acquisition tax credits. Most importantly, the building must not have been acquired from a person who is related to the taxpayer. "Taxpayer" in this instance refers to the individual taxpayer to whom the tax benefits are passed through, e.g., the individual partners in a partnership. In addition, there exists a prohibition, for purposes of low-income housing credit eligibility, against the Owner, or a related person, occupying one or more of the units in a building of four units or less unless the project is part of a development plan of action sponsored by the State, a local government, or a qualified nonprofit organization.

DCA requires that the Owner submit a legal opinion from its own attorney that states that in that lawyer's opinion, the project is eligible for acquisition credits. The legal Opinion for previous tax credit properties should include sufficient documentation for GHFA to confirm that the Compliance period has ended.

Sources of information regarding the Georgia Tax Credit Allocation Process

1. Each year, the final QAP is posted on the DCA website after it is signed by the Governor. The 2014 QAP is available on the DCA website.
2. Application and Application Instructions are posted on the DCA website. DCA's underwriting policies to determine project feasibility are outlined in the QAP and application instructions.
3. DCA Application Manual is posted on the DCA website at least two months before the application submission deadline.
4. Each Year, DCA has a General Questions and Answers and project specific Question and Answer period prior to the Application Submission deadline. Applicants are encouraged to resolve issues and clarify interpretations of the QAP during the question and answer periods. General Questions and DCA's answers are posted on the DCA website. Please refer any general or project specific questions to HFDDround2014@dca.ga.gov
5. DCA advisories are periodically posted on the DCA website.
6. Georgia Open Record Act documents. In order to schedule an appointment to review DCA documents subject to the Georgia Open Record Act, please contact Angel Gordon at 404-679-0650.

7. Competitive Round Tax Credit Deadlines (including Application submission and post award deadlines) and requirements are outlined in the QAP (including any amendment, if applicable). The 2014 Application Submission deadline is stated in the Core section of the 2014 QAP.

Eligible Buildings. For Low Income Housing Tax Credit purposes, the term “building” includes residential rental property that is an apartment building, a single family dwelling, a townhouse, a row-house, a duplex or a condominium. However, IRS regulations define a “building” or “structure” as a man-made construction consisting of an independent foundation, outer walls, and room. A single unit which is not an entire building, but is merely part of a building, is not considered a “building” or “structure” for tax credit purposes. DCA imposes its own requirements for certain types of buildings.

Rent and Occupancy Restrictions

Minimum Section 42 Set aside Elections. For every tax credit project, the Owner must covenant and agree to one of the following tax credit set asides ("Section 42 Rent and Occupancy Restrictions"):

20-50 Minimum Tax Credit Set-aside: At least 20% of the Units in the Project will continuously be maintained as both rent-restricted and occupied by individuals whose income is 50% or less of Area Median Gross Income. (If an Owner makes this election, all tax credit units will be rent and income restricted to 50% or less of Area Median Gross Income).

or

40-60 Minimum Tax Credit Set-aside: At least 40% of the Units in the Project will continuously be maintained as both rent-restricted and occupied by individuals whose income is 60% or less of Area Median Gross Income. (If an Owner makes this election, all tax credit units will be rent and income restricted to 60% or less of Area Median Gross Income).

The Owner has until the end of the first year of the tax credit period for the building to lease the specified number of units to eligible low-income tenants necessary to meet the minimum low-income occupancy requirements (20 percent or 40 percent based on the minimum percentage elected). **For projects consisting of more than one building, low-income occupancy compliance for the entire project must be met within this same time period.** [Section 42 (g)(3)]

GHFA Rent, Income and Occupancy Requirements. In the tax credit application submitted by the Owner of a project, the Owner may make additional representations to GHFA regarding rent, income and occupancy restrictions which may be more restrictive than those required by Section 42. These limitations may include but are not limited to:

- 50% Rent Restrictions/50% Income Restrictions where the Applicant agrees to set rents for a specified number of low-income units at or below 30% of 50% AMI. Owners will be required to execute restrictive covenants stipulating the number of very low rent-restricted units to be rented to very-low income households for the term of the Compliance Period or the Period of Affordability, (if applicable) whichever is longer.

These additional rent and income restrictions will be referenced in the Land Use Restrictive Covenant for the project.

Minimum Period for Rent and Income Restrictions. Section 42 Rent and Occupancy Restrictions shall remain in effect throughout the "extended use period." In accordance with Section 42, the extended use period shall commence with the first day in the compliance period on which any building that is part of the Project is placed in service and end on the date which is 15 years after the close of the compliance period. (Generally a period of 30 years). The GHFA Rent, Income and Occupancy Restrictions shall remain in effect through the "Compliance Period." Compliance period shall be the period of fifteen (15) taxable years beginning with the 1st taxable year of the credit period.

Termination of Rent and Income Restriction prior to end of Extended Use Period. The extended use period for any building that is part of the Project shall terminate:

- On the date the building is acquired by foreclosure or instrument in lieu of foreclosure except that for a period of three years following the termination of the extended use period, the Owner shall not evict the tenant of a Low-Income Unit or terminate the tenancy of an existing tenant of any Low-Income Unit other than for good cause and shall not increase the gross rent above the maximum allowed under the Code with respect to any such Low-Income Unit.
- On the last day of the one-year period that begins on the date Owner properly submits a written request to the Authority, asking the Authority to assist in procuring a "qualified contract," as defined in Section 42(h)(6)(F), for the acquisition of the low-income portion of the building, but only if the Authority is unable to present a qualified contract during such one-year period; provided, however, such request may not be made before the end of the 14th year of the compliance period or as agreed to by the Owner in its application.

Opt Out Provisions. After the 14th year of the compliance period, the Owner may submit a written request to DCA to find a person to acquire the Owner's interest in the low income housing tax credit project. The extended use period for any project shall terminate if the DCA is unable to present during such period a qualified contract for the acquisition of the project by a person who will continue to operate such project as a qualified low income project. The calculation of the qualified contract price shall be determined by reference to the IRC Section 42 and to DCA's written policies. This code provision effectively allows an Owner to "opt" out of the tax credit program after year 15 and before the expiration of the extended use period for the property. DCA has posted its "Year-15 Plan" on the DCA website.

Applicants may elect to waive their right to "opt" out of the program after year 14 in exchange for receiving points during the competitive round. Applicants who make this election will not be eligible to request that DCA present a qualified contract for the property during the period that has been waived by the Applicant. The Land Use Restrictive Covenant for the property will reflect any waiver of this right.

Combining Tax Credits with PBRA. Many projects that receive funding from DCA also have project based rental assistance (PBRA) contracts. However, the rules under the Section 8 PBRA program can conflict with tax credit rules. Applicants need to use care in identifying areas of both programs which can conflict so as to avoid situations where

the allocated tax credits could be subject to recapture. To initially certify a tax credit unit, the occupant must meet the income election of his designated set aside regardless of whether there is a Section 8 PBRA contract. This means, that if you have a 40/60 election and 100% of the units are tax credit units, all of the initial tenants in the project must be certified at 60% AMI or less. Problems can arise in an existing tax credit rehab property, if you have a tenant that is receiving PBRA but has income over 60%, but within the 80% PBRA requirement. That tenant would not meet the first year tax credit requirements. However, under Section 8 PBRA rules you could not evict the tenant or refuse to renew his lease. In a 100% tax credit project, the conflict between the different program requirements could create an insurmountable problem. Projects combining tax credits and PBRA can also have problems dealing with waiting lists, and with certain tenancies such as students.

DCA recommends that Applicants with projects that are 100% PBRA not structure their tax credit project with 100% tax credit units. This provides some flexibility resolving conflicts between the two programs.

Land Use Restrictive Covenants (LURC). DCA requires that the low-income housing commitment be recorded as a restrictive covenant after it makes an allocation of the credit or no later than the bond issuance date for a 4% credit project. The Code stipulates that no credit will be allowed for any year unless the required extended low-income housing commitment is in effect as of the end of the taxable year. However, if during a taxable year, it is determined that the commitment is not in place, the credit is disallowed for that year if the failure is not corrected within one year from the date the determination was made.

The LURC shall reflect all representations made in the original Application and any changes made to the original Application that have been approved in writing by GHFA. The LURC will be drafted after GHFA's receipt of the certification of the 10% test, and must be recorded upon its execution. For "4% credit" applications, the LURC is sent as an attachment to the Letter of Determination. All construction and/or permanent financing for the project must be subordinated to that portion of the recorded LURC that sets forth the requirements of Section 42 (h)(6)(E)(ii) of the Code. The LURC for projects funded in the competitive round will reflect representations made in the application for the purpose of obtaining points.

LURCs are prepared by the DCA Legal Affairs Department and subsequently e-mailed to Owners for review. Changes in unit mix, tenancy characteristics, or rent structure may be considered substantive changes and are subject to DCA approval. Any approved changes to the LURC must be reflected in the Final Allocation Application submitted to DCA. For information on the status of a LURC, you can contact Angel Gordon, 404-679-0650. DCA's receipt of the original recorded LURC is required prior to issuance of any Form 8609.

IRS Revenue ruling 2004-83 provides that Section 42(h)(6)(B)(i) requires that an extended low income housing commitment must include a prohibition during the extended use period against (1) the eviction or the termination of tenancy (other than for good cause) of an existing tenant of any low income unit (no cause-eviction protection) and (2) any increase in the gross rent with respect to the unit not otherwise permitted under Section 42.

General DCA Tax Credit Application Process

These procedures, instructions, and guidelines are subject to change at any time by DCA and may be supplemented by policies and procedures revised by DCA from time to time.

9% CREDIT PROJECTS

Applications for 9% tax credits must be submitted during one of DCA's announced application cycles. In determining when, during the project's development process, an application should be submitted, developers should do so no earlier than when all threshold requirements can be met. Credits should not be claimed prior to the issuance of an 8609 by DCA. **Applicants are strongly advised to consult an accountant or tax attorney with tax credit expertise regarding issues related to the use of and requirements for tax credits.**

Applications that are complete and pass the threshold criteria are evaluated using the scoring and selection described in the State's Qualified Allocation Plan. Projects thus selected are underwritten in a manner similar to loan underwriting. This is done in order to determine: (a) the credit amount necessary to support the low-income portion of the project; (b) the financial feasibility of the project; and (c) comparability and reasonableness of project cost. The amount of credit necessary to support the low-income portion of the project is calculated and carryover allocations are issued.

Rejection of Application Packages

The application package provided by DCA must be completed in its entirety. Minimum required supporting documentation must accompany the application. For 9% competitive Applications, Applicants are required to submit all documents at Application Submission that are necessary for DCA to determine that the Application meets the criteria for points regardless of whether they are listed in the minimum document requirements. DCA may reject any application that is incomplete or that is not accompanied by the appropriate application fee. Any application lacking the documentation needed to determine that the threshold criteria are met will not be evaluated. Applications will only be accepted during established cycles, except for tax-exempt bond financed projects that receive an allocation of tax credits independent of Georgia's Federal credit cap.

Disqualification of Applicants

Misrepresentation in any application or supporting documentation may result in recapture of tax credits by DCA, the barring of the project sponsor(s) or certifying independent certified public accountant from future program involvement, and notification to the Internal Revenue Service.

Project Changes

Since credits are awarded based on the project characteristics described in the initial application, any material changes that occur after initial application may trigger recapture of tax credits. **Without DCA's prior written approval, certain project changes are clearly disallowed as follows:**

- unit count and/or distribution,

- income and rent elections,
- rent structure,

Other project changes may also be disallowed as determined by DCA. Owners must consult with the tax credit program staff to obtain prior written approval before pursuing substantive project changes to avoid affecting the credits. Material changes, if approved, may require submittal of a revised application. DCA will charge a fee for reviewing project changes, including but not limited to unit mix, tenancy characteristics, rent structure and amenity changes.

- **Bond/ “4% Credit” Projects and Applicable QAP**

Projects of which fifty percent (50%) or more of the aggregate basis of the land and buildings are financed with the proceeds of obligations on which the interest is exempt from tax under section 103 of the Internal Revenue Code are eligible to receive Federal and State tax credits which are not subject to Georgia’s annual credit cap. Unlike projects that are part of Georgia’s annual credit cap, there is no reservation or carryover stage.

In order to receive tax credits, Section 42(m)(1)(D) of the Internal Revenue Code dictates that the tax-exempt bond-financed project must satisfy “the requirements for allocation of a housing credit dollar amount under the qualified allocation plan applicable to the area in which the project is located”.

It is critical that Owners of tax-exempt bond financed projects applying for tax credits read the allocation plan carefully. Owners of tax-exempt bond financed projects must meet all threshold requirements set forth in Appendix I of the Qualified Allocation Plan, with the exception of those threshold requirements which are specifically waived for tax-exempt bond financed projects and are so noted by an asterisk (*).—DCA shall be the sole entity responsible for making such a determination and must issue its opinion as to the project’s 4% Credit eligibility prior to Bond closing. The project must comply with the Plan in effect at the time of the Application submission.

Letter of Determination (LOD)

In making application for the Letter of Determination, an Owner must complete the standard Application, as well as provide all supporting documentation necessary to meet all applicable threshold requirements and pay an appropriate bond/4% credit eligibility fee and applicable waiver fees. DCA will provide its determination within the timeframe specified in the QAP. DCA’s determination notwithstanding, the issuer must still make its own eligibility determination. Prior to issuance of an LOD, DCA will require confirmation of the project financing from the applicant. Please note that the QAP requires a determination from DCA that the project meets the QAP requirements prior to the issuance of 8609’s. A letter of determination issued by an authority other than DCA will not guarantee that 8609’s will be issued for the project.

If the project is deemed to be eligible for State and federal tax credits, a LOD will be issued to the Owner. A LURC encompassing the federally-mandated extended use agreement as well as other representations made in the application, will also be sent to the Owner with the LOD. **Please note that a “4% credit” application must close on its debt and equity within 180 days from the date of the Letter of Determination, under substantially the same pricing and terms and conditions as presented for debt and equity in the Application to DCA, in order for the LOD to remain in force. Should debt and/or equity fail to close within the 180 day time frame, the Letter of Determination will expire.**

After a project is placed in service, Owners of tax-exempt bond financed projects must apply for IRS Form(s) 8609 by completing a Final Allocation Application. If applicable, opinion letters from the bond issuer as to the project’s eligibility for tax credits must be submitted with application for IRS Form(s) 8609.

Minimum Bond Application Review Requirements

Applicants are encouraged to submit their applications as soon as possible after the bond allocation, in order to allow completion of the Bond Application Review Requirements and market study. In all instances applications for 4% tax credits must be submitted no later 75 days prior to bond closing. All requests for architectural standard, operating cost, per unit cost and/or experience waivers must be submitted 30 days prior to Application submission.

DCA’s Application review will include, at a minimum, a financial feasibility evaluation, architectural review, a physical inspection of the property, an environmental review to ensure the quality of construction, and a compliance review. The Bond Application Review Requirements are to ensure adherence to the state and federal requirements relating to the tax credit and all applicable DCA policies, threshold requirements and Application submission requirements.

Market Study requirements. Effective January 1, 2001, federal law requires that every tax credit application be accompanied by a market study performed by a disinterested third-party analyst approved by DCA. DCA’s market study guidelines are posted on DCA’s website and are referenced in the QAP.

Allocation of Credit

The allocation of State and Federal credits by GHFA will proceed in the following general steps:

1. Carryover Allocation (Not applicable to Bond / 4% Credit Projects)

Projects that are not completed in the credit allocation year must receive a carryover allocation. GHFA typically issues carryover allocations to the tax credit awardees within one month after the tax credit award notification.

2. 10% Test (Not applicable to Bond / 4% Credit Projects)

The Code permits tax credit recipients to carry over an allocation for a particular year and place their buildings in service up to two years after the end of the allocation year provided more than 10 percent of the project’s reasonably expected total basis has been expended by one year after the carryover allocation date. Information on the 10% test,

including instructions, forms, and sample certification letters are available on DCA's website at least two months prior to the deadline of the 10% test.

3. Final Allocation

Final allocation of the credit amount to a project is made when the project is placed in service and corresponding evidence has been furnished to DCA with the Owner's Final Allocation Application. It is at this stage that Form 8609 / Form IT-HC is issued. Although carryover allocations/Letters of Determinations are issued on a project-wide basis, the final allocation must be made on a building-by-building basis.

The "maximum applicable percentage allowable" appearing on the IRS Form 8609 may not equal the applicable credit percentage elected or the one for the month the building is placed in service. DCA has the responsibility of determining how much credit a project needs for financial feasibility and viability as a low-income project. DCA may, therefore, reduce the applicable credit percentage in determining the credit amount.

Prior to issuance of Form 8609/Form IT-HC, DCA or a representative authorized by DCA will inspect the tax credit development to ensure construction quality, fulfillment of Owner's representations made in the application, and compliance with all applicable laws and regulations. In addition, DCA will conduct a compliance review. All issues related to the construction inspection and compliance review must be resolved to DCA's satisfaction prior to issuance of any Form(s) 8609. All applicable fees must be paid. DCA must also receive the original recorded land use restrictive covenant.

The credit allocation is made to the Ownership entity by the issuance of IRS Form 8609/form IT-HCs. DCA issues only one copy of Form 8609 /Form IT-HC (per residential building) and it is the Owner's responsibility to furnish the requisite copies to its partners for filing with the IRS. Final Allocation Applications will be reviewed in the order that they are received. Incomplete packages or non payment of fees may result in a delay in the issuance of 8609 forms. Final Allocation Application forms are available on DCA's website at www.dca.ga.gov.

Basis Concepts

Eligible Basis

The eligible basis of a new building is its adjusted basis used to calculate depreciation, which is generally the development cost minus the cost of land, land related fees, and investment and permanent financing costs. [Section 42 (d)]. In all other cases, the following applies:

- A. New construction:
The eligible basis of a new building is its adjusted basis as of the close of the first taxable year of the credit period. [Section 42 (d)(1)]

- B. Acquisition:
The eligible basis of an existing building that is being acquired in accordance with the 10-year rule is:
 - (1) its adjusted basis as of the close of the first taxable year of the credit period (generally its acquisition cost), and
 - (2) zero in any other case.

C. Rehabilitation over \$6,000 per low-income unit or 20 percent of adjusted basis:

The eligible basis for an existing building involving rehabilitation expenditures of at least 20 percent of its adjusted basis or \$6,000 per low-income unit is equal to the allowable rehabilitation expenses incurred during any 24-month period with certain exceptions. [Section 42 (d)(2)]

Note: Although the Code establishes the minimum expenditure for rehabilitation projects at the greater of \$6,000 per unit or 20% of building adjusted basis, DCA policy is more restrictive and is outlined in the QAP.

For tax credit purposes, there is no basis adjustment for depreciation. Common areas or amenities available for use by all the tenants are taken into account in determining the adjusted basis if no separate user fees are charged. [Section 42 (d)(4)]

As originally enacted, the Tax Reform Act provided that a building's eligible basis would be determined on the day it was placed into service. As amended, the Code has been modified to permit eligible basis to be determined at the same time qualified basis is established, i.e., the end of the first year of the credit period. Project Owners, therefore, may include the cost of items or work performed after the project is placed into service.

The eligible basis is reduced if the low-income units are not "comparable" to the other units in the project. If the construction or acquisition costs are comparable and the units are provided in similar proportion for both low-income and other tenants, the units are considered to be of comparable quality. Federal regulations allow a differential in square footage cost of up to 15 percent for the market rate units. If any market rate units are of a higher quality or provide additional amenities, the adjusted basis for those units is subtracted from the eligible basis; or upon election, the excess cost is excluded from the eligible basis if the cost differential does not exceed 15%. The percentage of low-income units to the total project remains the same, but is applied against the lower eligible basis. [Section 42(d)(3)]

The eligible basis of a project may be increased in certain low-income and high cost areas as designated by HUD. In census tracts where at least 50 percent of the households have an income which is less than 60 percent of the area median income, or which has a poverty rate of at least 25 percent, ("qualified census tract") a project's eligible basis attributable to rehabilitation expenditures and new construction costs may be increased by up to 30 percent. This means that projects in very low-income neighborhoods can attract additional equity, however the project must also contribute to a concerted community revitalization plan for a specific neighborhood. A maximum 30 percent increase in basis will also apply to projects located in certain "difficult development areas," i.e., a limited number of metropolitan and non-metropolitan areas with high construction, land, and utility costs relative to the area median income. HERA authorizes the state tax credit allocation agency to designate areas not located within a DDA or QCT to apply up to 30% basis boost. Such state designated areas are outlined in the QAP.

Qualified Basis

The qualified basis is equal to the percentage, or "applicable fraction", of the eligible basis attributable to the low-income units. The applicable fraction is the smaller of (a) the percentage of low-income units to total units; or (b) the floor space of low-income units to the total floor space of the residential rental units. [Section 42 (c)]

Only those units that are occupied by low-income persons may be included in determining the qualified basis during the first year of the credit period. (Common space units are excluded in the applicable fraction calculation.) Subsequently, a unit previously occupied by low-income persons and then vacated may count as a low-income unit as long as no other unit of equal or smaller size is rented to a non-low income tenant following such vacancy.

Special rules apply for determining qualified basis where a portion of a building is used to provide supportive services for the homeless. The qualified basis may be increased by the lesser of (a) the eligible basis used annually to provide supportive services that assist tenants in finding and retaining permanent housing; or (b) 20 percent of the qualified basis of the building.

Eligible Financing

Almost all qualified rental projects are eligible for tax credits regardless of the type of financing or federal subsidy. HERA eliminates below-market federal loans from the definition of federally subsidized properties, allowing the 9 percent credit on properties with below market rate federal loans, effective for buildings placed in service after date of enactment.

Tax credits can be used in conjunction with:

- A. Tax-exempt bond financing
 - "4% Credits" New Construction
 - "4% Credits" Rehabilitation
 - "4% Credits" Acquisition

If 50 percent or more of the aggregate basis is financed with bonds for which an allocation of the State private activity bond volume cap was awarded, a separate tax credit allocation from the housing credit agency is NOT required. However, the project is subject to the State Qualified Allocation Plan. If less than 50 percent of the cost of the aggregate basis is financed through the issuance of tax-exempt bonds, a credit allocation must be obtained for the non-bond portion through the State allocating agency from the State's authority.

- B. Other debt financing
 - 9% Credits New Construction
 - 9% Credits Rehabilitation
 - "4% Credits" Acquisition

HERA eliminates the concept of "below market federal loans" from "federal subsidies" for the projects that are placed in service after the enactment of HERA. New construction

and rehab projects with below market rate federal loans are now eligible for 9% credit if the placement in service requirement is met.

C. Federal grants

A federal grant for project development will reduce the project's eligible basis.

HERA provides that federal rental assistance (such as HUD Sec. 8), operating and interest reduction payments are not considered federal grants requiring a basis reduction. In addition, the act provides that loans derived from federal grants do not require a basis reduction.

CREDIT ALLOCATION PROCEDURES

DETERMINATION OF CREDIT AMOUNT

As required by law, the allocated tax credit amount cannot exceed the amount necessary to support the low-income portion of the project. [Section 42(m)(2)]

The credit amount will be calculated at each of the applicable stages: application review, carryover allocation and final allocation. The amount of credit awarded to a project may change from stage to stage if any of the factors used in calculating the credit change. The following guidelines will apply in determining the amount of credit to be allocated to individual projects:

Project Cost Review. Each project will be evaluated for comparability and reasonableness of project cost. Costs will be reviewed against those from projects of past years, regional data, third party documentation, and other factors and data as determined at the discretion of DCA to bear upon the issues of comparability and reasonableness of project costs. Intermediary costs, defined as the project costs related to consultants and syndication, will be reviewed in accordance with the provisions of Section 42(m)(2)(ii) of the Code. Additional documentation from the Applicants may be requested to assist in the review. Applicants will be notified if any adjustments seem necessary.

Debt Review. Projects will be evaluated for debt capacity. At the early stages of the development process, DCA recognizes that firm financing commitments usually are not in place. Applicants should provide preliminary conditional financing commitments and term sheets, which will be reviewed for feasibility. Rents, utility allowances, vacancy rates, and operating expenses will be reviewed for comparability and reasonableness in accordance with established policies (see below). Additional documentation from the project Applicants may be requested in accordance with the QAP to assist in the review. Applicants will be notified if any adjustments seem necessary.

The debt coverage ratio and comparable financing terms used by DCA will be determined through consultation with banking and syndication experts, will reflect typical market terms, and will be updated as appropriate to reflect market changes. The maximum loan amount, including any subordinated debt the project is expected to receive, will constitute the debt figure used in the tax credit calculation.

Equity gap. The equity gap is defined as the total project cost minus all sources of funds (exclusive of any projected deferral of a portion of the developer's fee), that is, the project cost not covered by debt financing and grants. The tax credit award is calculated such that, over ten years, the award amount equals the excess project cost, thereby "closing" the equity gap. This amount may be less than the 4 percent or 9 percent maximum allowable credit. If federal credits are syndicated, less than the full 10-year tax credit award is returned to the project as equity; a portion is consumed by syndication expenses, project reserves and return requirements of investors.

The credit calculation takes the amount of credit returning to the project into account through the **equity factor** (also referred to as "pricing"). The equity factor is the proportion of the 10-year credit returned to the project sponsor in the form of equity. A syndication contract or limited partnership agreement detailing the distribution of the gross syndication proceeds should be included in the application.

Credit Calculation. The credit calculation yields the amount of credit needed to fill the equity gap, thereby financing the project cost not covered by debt and other sources, making the project financially feasible.

To calculate the "equity gap amount", the following method is used:

Project Cost - Sources = Equity Gap

The Owner provides information on the project cost and sources of funding in the Application. The difference between the two is the equity gap, which needs to be "filled" to pay all project cost, thus enabling the project to be built. For example, Project A will cost \$5,000,000 to build and the Owner has obtained financing in the amount of \$2,000,000. The equity gap to be filled equals \$3,000,000. Since the credit amount can be taken each year for ten years, and the credit allocation to be calculated is the first year credit amount only, the equity gap is divided by 10 (the number of years in the credit period) to obtain the annual credit amount.

Equity Gap ÷ 10 = Annual Equity Amount

Dividing Project A's equity gap of \$3,000,000 by 10 yields an annual equity amount of \$300,000. That is, the Owner needs to receive \$300,000 cash from the tax credit each year to cover the cost of the project not financed by the mortgage.

The annual equity amount is then divided by the equity factor, to factor out that portion of the credit not going to the project. For example, 75 cents of every Federal tax credit dollar and 30 cents of every State tax credit dollar will go to the project (again, the balance is eaten up by syndication expenses and the time value of money), for a total of \$1.05. The resulting credit figure is the amount needed to cover project cost for which no funds are available, taking into account the pay-in to the project of the credits.

Annual Equity Amount ÷ Equity Factor = Annual Credit Amount Required

Continuing with the example of Project A, to determine the credit amount required by this project to fill the equity gap, the Owner must divide \$300,000 by the expected equity factor of \$1.05 for every tax credit dollar (State and Federal combined). Based on this

calculation, the Owner needs \$285,714 in Federal tax credits (plus \$285,714 in State tax credits) allocated annually to raise sufficient funds to complete the project (at 75 cents on the dollar, if the project had to use Federal credits alone, it would require \$400,000 in credits to fill the gap).

Maximum Credit Amount

The actual credit amount assigned to a project equals the lesser of the equity gap credit amount or the maximum credit amount. To calculate the maximum credit amount, the following method is used:

$$\text{Qualified Basis} \times \text{Applicable Credit Percentage} = \text{Maximum Credit Amount}$$

The credit amount allocated is frequently less than the maximum credit amount. The allocated credit amount may be less than the requested amount if DCA determines that the proposed eligible basis is either financially infeasible or ineligible or for such other reasons as DCA may deem necessary or appropriate for the administration of the program. The credit amount may also change from stage to stage in the allocation process as initially proposed project costs, financing or syndication terms are finalized, but will not increase beyond the carryover allocation.

Maximum effort will be made not to jeopardize a project's viability by making minor adjustments in the tax credit amount for the project. Should the sources or uses of funds change after the original application, such that the equity gap is reduced, project improvements may be allowed, if possible, so that the tax credit amount can remain the same. Project improvements may include increasing project amenities, serving additional low-income tenants, or reducing rents on a portion of the project.

Credit Allocation Disclaimer

DCA makes no representations or warranties regarding the amount of credit or the appropriateness of credit allocation to any project. Project applicants are expected to provide DCA with sufficient information to document the eligible and qualified basis and the amount and terms of financing and equity contributions in any project.

Credit Recapture

Owners of projects not meeting program requirements may lose their tax credits. DCA will not refund any allocation fees to Owners of projects whose credits are recaptured.

Tax Credit Computation/Underwriting

Credit Calculation. Under the Code, tax credits cannot exceed the amount necessary to support the low-income portion of the project. The Code requires that the credit amount be calculated at application, allocation, and placed-in-service date. Credit amounts may fluctuate from stage to stage as project costs, operating expenses, financing and syndication terms are finalized. DCA will estimate the Federal and State credit amounts at carryover allocation. Generally, any increase in the credit amount will be based on changes in both the sources and uses of funds and not on increased project costs alone. Please note that if the amount of credit necessary for financial feasibility due to circumstances causing significant unforeseen cost increases over the amount shown on the Carryover Allocation, the Owner must apply and compete for additional credit in the funding round in the year the project is placed in service. Additionally, the

applicant must meet the criteria for additional tax credits as outlined in the appropriate QAP.

Credit Calculation Assumptions. The credit calculation at the carryover stage will be, in most cases, based on cost and financing estimates rather than actual numbers. DCA will carefully review the estimates to determine that project costs are documented and/or reasonable, debt capacity has been determined using documented and/or reasonable income and expenses, debt capacity is fully utilized, subordinated debt is fully accounted for, and the calculated credit does not exceed the statutory limit. The actual financing and syndication terms, as soon as available, will be used to calculate the tax credit amount (at Final Allocation).

Assumptions for Building Basis. For purposes of underwriting acquisition Credits, the building basis must be limited to the lesser of the sales price or the appraised value of the building(s). The appraised value will be the basis for determining the appropriate sales price when an Identity of Interest exists between the buyer and seller, and additional scrutiny will be applied to any sales of the project in the three year period prior to the date of the sales contract.

Employee Unit Designation. For Applicants electing to house management, security, or maintenance personnel in a project unit, the employee unit can be either designated as part of the residential unit count or as part of the common space. If the employee unit is designated as part of the residential unit count, and is also designated as a low-income unit, then an income eligible household must occupy it. This income eligible household may be the on-site management, security or maintenance personnel. Rent can be charged and collected by the Owner for this unit. If the employee unit is designated as part of the common space, it need not be occupied by an income-eligible household, but must be occupied by a full time on-site manager, security or maintenance personnel. No rent can be charged or collected by the Owner for a unit designated as common space.

Identity of Interest. Any Person involved with a LIHTC application, must abide by the requirements as outlined in the QAP with regard to Identity of Interest. The determination of whether or not any terms and conditions proposed by the related party are reasonable and customary is at DCA's discretion.

Land (and existing building) Purchase. For Applications where there is an Identity of Interest between the buyer and seller for any site(s) within the project, an appraisal no more than 6 months old and prepared by a certified general appraiser must be submitted with the Application as a basis for the determination of the appropriate sales price. The appraisal must be prepared in accordance with the DCA Appraisal Guide and must provide separate valuations for the land and existing buildings. The lesser of the sales price or the 'as is' appraised value will be the basis for determining the appropriate sales price. See QAP Appendix I for further appraisal requirements.

Land Use Restrictions. When there is more than one financing source imposing land use restrictions on a project, e.g., a HOME Loan and Credits, there may be restrictions from one program that are more restrictive than similar restrictions in the other program(s). In such instances, the most restrictive requirements will apply to the project.

Utilization of Resources. While DCA promotes a variety of projects that may include the re-use of contaminated land, in-fill, adaptive reuse, preservation of affordable housing and historic sites and will consider mitigation of certain factors inherent in their location, DCA is required to take any actions necessary or convenient to ensure the complete, effective, efficient and lawful allocation of and utilization of the low income housing credit program. Therefore, in spite of a project's score under the Plan, DCA will review all projects proposed for reasonableness, which may include a review of the degree to which the use of resources are being directed specifically toward the program goals of providing safe, decent and affordable housing that is also viable physically, operationally and economically over time.

UTILIZATION OF THE CREDITS

Credit Allocation Provisions

The credit taken during the Credit Period may not exceed the credit amount allocated by DCA. An allocation is generally effective only if it occurs in the same year that the building is placed in service and if the allocation is made no later than the close of the calendar year in which the building is placed in service. The allocation will specify both the allocated maximum **qualified basis** and the **credit percentage**.

Allocation of Credits on a Project Basis

In general, in the case of a project which includes (or will include) more than one building, an allocation is effective only if:

- the allocation is made to the project for a calendar year during the project period which is the time between first building's allocation and the last building's allocation in the project;
- the allocation only applies to buildings placed in service during or after the calendar year for which the allocation is made; and
- the portion of such allocation, which is allocated to any building in such project, is specified not later than the close of the calendar year in which the building is placed in service. [42(h)(1)(F)]

Carryover and Reallocations

Post-1989 credit authority may be carried over on a statewide as well as project basis. Thus, DCA effectively has two years within which to allocate any particular year's credit ceiling. Credits not allocated by DCA by the end of the second year are to be reallocated among the states that have used all of their allotments. In any year, DCA can recapture allocations from projects that do not go forward or projects that do not become qualified low-income projects within the applicable period. Such amounts can then be reallocated to other projects. [Section 42(h)(3)]

First Year Credit Determination

The credit may first be claimed either for the year the building is placed in service or the next taxable year. [There is an exception for the acquisition credit. See Section 42(f)(5).] The Owner must choose in which year the credit period begins and, once chosen, the election is irrevocable. The term "placed in service" has different meanings depending upon the type of activity as explained below:

New Construction

For new construction, a building is Placed In Service on the date the building is suitable and available for occupancy (usually evidenced by a Certificate of Occupancy issued by the local government).

Acquisition

A transfer of the building Ownership results in a new Placed In Service date if, as of that date, the building is occupied or ready for occupancy.

Rehabilitation

A building involving rehabilitation is treated as placed in service at the close of any 24-month period during which rehabilitation expenditures averaging at least 20 percent of the building's adjusted basis or \$6,000 per low-income unit, whichever is more, were made. This placed-in-service date applies even if the building is occupied during the rehabilitation period.

First Year Proration

During the first year of the Credit Period, the credit allocated based on the qualified basis for any building will not be the full amount of the credit allocated, if all of the planned low-income units are not occupied during the first month. To determine the amount of the credit to be taken, an averaging convention is used. The qualified basis is calculated at the close of each full month of the first credit year and added to the qualified basis of the preceding months. The cumulative total is then divided by 12 months. Any resulting reduction in the credit allocated for the first taxable year of the credit period may be taken in the first taxable year following the credit period which would generally be the eleventh year after the building has been placed in service. [Section 42 (f)]

Failure to use Previously Awarded Credits

DCA's policy is that projects awarded credits must be completed by the applicable Placed-In-Service date. An Owner who cannot utilize awarded credits for any reason must still pay the credit allocation fee for the project. Provided the Owner returns the credits and paid the applicable tax credit allocation fee in a timely manner, the project is eligible to be resubmitted in a future application round. The Owner must inform DCA of its intent to return credits. DCA will then direct the Owner on the proper timing and process for returning the credits. If the resubmitted Application is approved, the Owner will pay a new credit allocation fee. In very limited circumstances, DCA will consider a forward exchange of credit if a delay in completion is due solely to circumstances beyond the control of the Owner/developer. Examples of such delays include unforeseen sewer issues, delays due to HUD policy and procedure or for extraordinary delays in the issuance of local development or building permits. In the event DCA does approve a forward exchange, the Placed In Service date will be extended for only a period of six months. Failure to meet that extended Placed In Service date (6 months) will be considered a major instance of non-compliance and will be considered in DCA compliance scoring.

OWNER REQUIREMENTS

1. Compliance with Low-Income Housing Tax Credit Requirements

Owners are responsible for operating projects in compliance with the Code. To assure compliance with the Code, the IRS has established minimum procedures, record keeping

and reporting requirements for allocating agencies and Owners to follow. DCA has prepared a compliance monitoring plan that complies with the regulations. The compliance monitoring plan is part of the State's Qualified Allocation Plan. DCA has also developed a separate compliance manual for project Owners and managers in which it sets forth in more detail how projects will be monitored.

Representative(s) authorized by the Owner/general partner are strongly encouraged to successfully complete a compliance training seminar. The Owner of the Tax Credit property will be required to submit to DCA a copy of the certificate of successful completion for the training prior to the beginning of the lease-up or, prior to placing the first building in service.

2. Owner Certification to IRS

Following the close of the first taxable year in the Credit Period for any qualified low-income building, the credit user must file with IRS Form 8586, "Low-Income Housing Credit", Schedule A, "Annual Statement", and a copy of the IRS Form 8609 "Low-Income Housing Tax Credit Allocation Certification." If the credit user received a carryover allocation, a copy of that document must also be filed for the first tax year in which the credit is claimed. Form 8609 is the official allocation form from DCA to the Owner and contains the following information:

- A. **Allocation of Credit** (to be completed by GHFA). Identifies the Owner, the building, the building identification number (BIN), and the housing credit dollar amount allocated.
- B. **First-Year Certification** (this may be the taxable year in which the building was placed in service or the subsequent taxable year, at the taxpayer's election; to be completed by the Owner only in the first credit year). Certification contains basis information for the building and various elections by the Owner as to the set-aside requirement, start of credit period, and other selection.

Failure to submit the required IRS forms by the date specified will result in the credit being disallowed. [Section 42 (I)]

3. Owner Certification to the Georgia Department of Revenue/Department of Insurance

Following the close of the first taxable year in the Credit Period, and for each year of the Credit Period, for any qualified low-income building, the State Credit user must file Form(s) IT-HC and any required attachments with his/her Georgia income tax return or insurance premium tax return with the Georgia Department of Revenue and/or Department of Insurance. This format will identify the Owner, the building, and the amount of State Credit assigned, as well as providing a mechanism to allow the user to document its connection to the Ownership entity.

4. Qualified Nonprofit Organizations

By Federal statute, 10 percent of Georgia's tax credit authority is reserved for use by qualified nonprofit organizations, which collaborate in some manner with for-profit entities. Qualified nonprofit projects also benefit from a number of other privileges granted by the tax code under its at-risk rules and the 10-year rule. Qualified nonprofit organizations are those that:

- A. have been granted tax-exempt status under paragraph (3) or (4) of Section 501(c) of the Internal Revenue Code; and
- B. have as one of their exempt purposes the fostering of low-income housing (DCA requires that this purpose be clearly stated and not subject to interpretation or implication);
- C. are not affiliated with or controlled by a for-profit organization; and
- D. own an interest in the low-income project (directly or through a partnership).

In Federal regulations, Congress clarifies that the set-aside can be used by for-profit corporate subsidiaries of qualified nonprofit organizations, so long as 100 percent of the stock of such subsidiaries is owned at all times during the period such subsidiary is in existence by one or more qualified nonprofit organizations.

The qualified nonprofit is required to "materially participate in the development and operation of the project throughout the compliance period". As such, it must have a role in the development as well as in the Ownership and continued management of the project. At present, there is no consensus on the amount of Ownership interest that must be retained by the nonprofit partner in a syndication to maintain the qualified nonprofit project status for tax credit purposes. State and local laws may affect the minimum degree of Ownership required to maintain the project's eligibility for the nonprofit set-aside. Treasury Regulation 1.469-5T states that to be considered as a material participant for any tax year, an individual can satisfy any one of the following tests:

- participates in the activity for more than 500 hours during the tax year
- participation in the activity for the taxable year constitutes substantially all of the participation in such activity for all individuals for that year
- participation in the activity is more than 100 hours during the taxable year, and this participation is not less than the participation of anyone else.
- activity is a significant participation activity and all of the participation in all such activities exceeds 500 hours per tax year
- acts and circumstances show that the participation in the activity was on a regular, continuous, substantial basis during the tax year.