National Housing & Rehabilitation Association

Asset Management Conference

June 11-12, 2018 Bethesda, MD

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Overview

- LIHTC itself emerged from the Tax Cuts and Jobs Act largely unchanged
- Other main provisions of the Act cause a significant impact on the value of the credit to investors
  - Corporate rate change from 35% to 21%
  - Changes to ADS lives for Real Property
  - 100% expensing for qualified property
  - Business interest expense limitation
  - Excess business loss limitation
  - Net operating loss limitations
  - Other miscellaneous items

Overview

	Old Law	New Law
Depreciation period	30	30
Useful life	15	15
Historical cost - Real Property	10,000,000	10,000,000
Tax rate	35%	21%
Discount rate	5%	5%
Total tax savings	1,750,000	1,050,000
Net Present value	1,210,960	726,576

Depreciation Changes

- Changes to Bonus Depreciation
  - 100% expensing of certain assets (phases down beginning 2023)
  - Effective for assets purchased after September 27, 2017 (retroactive)
    - Impact of assets under construction prior to 9/27
    - Phase down under old law – need to be aware of asset additions that fall under old law
  - Used property now qualifies
    - Old Law – property had to be new to qualify for bonus
    - 20 year life or less qualifies

DEPRECIATION CHANGES

- Changes to Bonus Depreciation
  - Not permitted for assets required to use ADS depreciation
    - Elect ADS, must still elect out of bonus depreciation
  - Taxpayers can elect out of bonus depreciation (same as current law)
  - Impact on acquisition credits & allocation of purchase price
    - Taxpayer must be aware of allocation among asset classes if significant rehab will be complete

Depreciation Changes

- Phase out of Bonus Depreciation
  - 100% for any qualifying asset placed in service after 9/27/17 and before 12/31/2022
  - 80% for any asset placed in service in 2023
  - 60% for any asset placed in service in 2024
  - 40% for any asset placed in service in 2025
  - 20% for any asset placed in service in 2026, and
  - 0% for any asset placed in service AFTER 2026

Depreciation Changes

	Old Law	New Law
Qualified Property - 5 Year	1,250,000	1,250,000
Qualified Property - 15 Year	1,250,000	1,250,000
Depreciation Year 1	1,406,250	2,500,000
Depreciation Year 2	259,375	-
Depreciation Year 3	173,438	-
Depreciation Year 4	120,125	-
Depreciation Year 5	115,313	-
Total Thru Year 5	**2,074,500**	**2,500,000**
Tax Savings Year 1	492,188	875,000
Tax Savings Year 2	90,781	-
Tax Savings Year 3	60,703	-
Tax Savings Year 4	42,044	-
Tax Savings Year 5	40,359	-
Total Tax Savings	**726,075**	**875,000**
Net Present value	**669,741**	**833,333**

Depreciation Changes

- Changes to ADS Depreciation
  - "Alternative Depreciation System"
  - Taxpayer will recover the cost of an ADS asset at a slower rate than it would "regular" depreciation
  - Residential property is now 30 years (from 40 years)
    - Impact of property placed in service pre-2018
    - Impact of LIHTC partnerships electing into ADS lives
  - Commercial property ADS remains at 40 year life

Depreciation Changes

- Technical Termination Repealed
  - Effective for tax years beginning after 2017
  - Generally favorable development
    - Eliminate the need to restart depreciation
    - Alleviate the late filing penalty
  - Unfavorable results
    - Lose ability to eliminate unfavorable elections (i.e. make new elections)
  - Allocation of bonus depreciation (old law vs new law)

Depreciation Changes

- Other Items
  - Adjusters in LPA related to Bonus Depreciation
  - Mixed use development – 80 percent gross receipts test

Business Interest Expense Deduction

- Business interest expense is limited to the sum of:
  - Interest income, plus
  - 30 percent of adjusted taxable income (EBIDA through 2021)
- Old Law - Taxpayers can generally deduct business interest

BUSINESS INTEREST EXPENSE DEDUCTION

- Adjusted taxable income is taxable income without taking into account:
  - Non-business income
  - Business interest expense or business interest income
  - Net operating loss deductions
  - 199A Deduction
  - Depreciation, amortization, or depletion

Business Interest Expense Deduction

- Limitation does not apply to investment interest
- Adjustment for depreciation, amortization, or depletion applies only through 2021
  - More restrictive limitation in 2022
- Applies to all business entity types
- Applied at the entity level
- Interest not deductible is carried forward indefinitely

Business Interest Expense Deduction

- Exceptions to the Limitations
  - Small Business Exception
  - Electing Real Property Business
  - Electing Farming Business
  - Utility Companies

- Small Business Exception
  - “Small” taxpayers with average annual gross receipts of $25M or less (subject to aggregation rules) are **exempt** from the limitation
  - Difficult to be considered “small” after aggregating construction, management, development, and rental activities
  - Tax Shelters do not qualify

- Definition of Tax Shelter
  - Any entity, plan, or arrangement where a significant purpose is the avoidance of federal income tax.
  - Any enterprise (other than a C corporation) that has had interests offered for sale in an offering required to be registered with any federal or state regulatory agency.
  - Syndicate – defined as a partnership or other entity (excluding C corps) where more than 35 percent of the entity's losses are allocable to "limited partners or limited entrepreneurs" – LIHTC deal is considered tax shelter

Business Interest Expense Deduction

- Electing Real Property Business
  - Taxpayers engaged in real property business may elect to NOT have the interest limitation apply to their business
    - Development
    - Construction
    - Rental
    - Management
    - Brokerage Business

Business Interest Expense Deduction

- Electing Real Property Business
  - Taxpayers engaged in real property business may elect to NOT have the interest limitation apply to their business
    - Development
    - Construction
    - Rental
    - Management
    - Brokerage Business

Business Interest Expense Deduction

- Electing Real Property Business
  - Election is irrevocable
  - Electing taxpayers are required to use the alternative depreciation system for real property
  - Trade off is relatively small for real property placed in service post 2017
    - 27.5 year life to 30 year life
  - Trade off is significant for real property placed in service pre 2018 (absent technical correction)
    - 27.5 year life to 40 year life

Business Interest Expense Deduction

- Pass-Through Entities
  - Interest limitation is applied at the entity level
  - Excess interest expense carries over
    - S-Corp carries excess over at the entity level
      - Shareholder does not reduce its basis in the S Corp stock
    - Partnership allocates to the partners with the excess interest carried over at the partner level until partner is allocated excess taxable income from that entity
      - Partner reduces its basis in the partnership when the interest is incurred (without regards to deductibility)

Business Interest Expense Deduction

	Example 1 - Prior to 2022	Example 1 - Post 2021
Building Basis	10,000,000	10,000,000
Placed-In Service Date	1/1/2008	1/1/2008
Annual Depreciation - MACRS	363,636	363,636
NBV at 1/1/2018 & 1/1/2022	6,363,636	5,272,727
Annual Depreciation - ADS (40 Year & 30 Year)	212,121	195,286
Rental Income (Loss) before Interest & Depreciation	100,000	100,000
Interest	(100,000)	(100,000)
Depreciation - "Regular"	(363,636)	(363,636)
Net Rental Income (Loss)	**(363,636)**	**(363,636)**
Business Interest Expense Limitation		
Net Taxable Income before Limitation	(363,636)	(363,636)
Add back: Net interest expense	100,000	100,000
Add back: Depreciation	363,636	-
Adjusted Taxable Income	**100,000**	**(263,636)**
30% Limitation	30%	30%
Business interest deduction limitation	**30,000**	**-**
Disallowance of Interest Expense (Carried Forward Indefinitely)	70,000	100,000
Net Rental Loss if Election is NOT Made	(293,636)	(263,636)
Net Rental Loss if Election is Made	(212,121)	(195,286)

Business Interest Expense Deduction

	Example 2 - Pre 2021	Example 2 - Post 2021
Building Basis	10,000,000	10,000,000
Placed-In Service Date	1/1/2008	1/1/2008
Annual Depreciation - MACRS	363,636	363,636
NBV at 1/1/2018 & 1/1/2022	6,363,636	5,272,727
Annual Depreciation - ADS (40 Year & 30 Year)	212,121	195,286
Rental Income (Loss) before Interest & Depreciation	100,000	100,000
Interest	(200,000)	(200,000)
Depreciation - "Regular"	(363,636)	(363,636)
Net Rental Income (Loss)	**(463,636)**	**(463,636)**
Business Interest Expense Limitation		
Net Taxable Income before Limitation	(463,636)	(463,636)
Add back: Net interest expense	200,000	200,000
Add back: Depreciation	-	-
Adjusted Taxable Income	**(263,636)**	**(263,636)**
30% Limitation	30%	30%
Business interest deduction limitation	-	-
Disallowance of Interest Expense (Carried Forward Indefinitely)	200,000	200,000
Net Rental Loss if Election is NOT Made	(263,636)	(263,636)
Net Rental Loss if Election is Made	(312,121)	(295,286)

Business Interest Expense Deduction

	Example 3 - Pre 2022	Example 3 - Post 2021
Building Basis	10,000,000	10,000,000
Placed-In Service Date	1/1/2018	1/1/2018
Annual Depreciation - MACRS	363,636	363,636
NBV at 1/1/2018 & 1/1/2022	10,000,000	10,000,000
Annual Depreciation - ADS (40 Year & 30 Year)	333,333	333,333
Rental Income (Loss) before Interest & Depreciation	100,000	100,000
Interest	(100,000)	(100,000)
Depreciation - "Regular"	(363,636)	(363,636)
Net Rental Income (Loss)	**(363,636)**	**(363,636)**
Business Interest Expense Limitation		
Net Taxable Income before Limitation	(363,636)	(363,636)
Add back: Net interest expense	100,000	100,000
Add back: Depreciation	363,636	-
Adjusted Taxable Income	**100,000**	**(263,636)**
30% Limitation	30%	30%
Business interest deduction limitation	**30,000**	-
Disallowance of Interest Expense (Carried Forward Indefinitely)	70,000	100,000
Net Rental Loss if Election is NOT Made	(293,636)	(263,636)
Net Rental Loss if Election is Made	(333,333)	(333,333)

Business Interest Expense Deduction

- Takeaways
  - Taxpayers must project the costs and benefits of electing the interest expense not to apply
  - Expectation is most rental properties (including LIHTC) will make election
  - Depends on placed in service date (absent technical correction)
  - Impact to syndicators regarding bridge loan interest

Business Interest Expense Deduction

- Takeaways
  - Depends on how leveraged the project is
  - Look to LPA to determine if election is required and when election is required
  - Interest expense will reduce capital accounts - regardless of current year deductibility of interest expense
  - LPs will have opinion since 99.99% of losses are going to the LP
    - GP and LP will have to work together with advisors to determine timing of election

Excess Business Loss Limitation

- Excess business loss of noncorporate taxpayers disallowed
  - Excess business losses of noncorporate taxpayers are not allowed for tax years beginning after December 31, 2017, and before January 1, 2026
  - Any excess business loss that is disallowed is treated as a net operating loss (NOL) carryover to the following tax year
  - Noncorporate taxpayers must apply this rule for excess business losses after applying the passive activity loss rules

Excess Business Loss Limitation

- An "excess business loss" is the excess, if any, of:
  - the taxpayer's aggregate deductions for the tax year from the taxpayer's trade or businesses, determined without regard to whether or not such deductions are disallowed for such tax year under the excess business loss limitation, over
    - the sum of:
      - the taxpayer’s aggregate gross income or gain for the tax year from such trades or businesses, plus
      - $250,000, adjusted for inflation ($500,000 for a joint return)f:

Excess Business Loss Limitation

- Example: For taxable year 2018, individual has nonpassive business income with $1M of gross income and $2M of deductions. In tax year 2016, individual paid taxes on income of $1.5mm.

Excess Business Loss Limitation

Pre-2018 tax law

Gross income	1,000,000
Deductions	(2,000,000)
Net loss	(1,000,000)
NOL carryback to 2016	1,000,000
NOL carryforward	-

Excess Business Loss Limitation

Post-2017 tax law

Gross business income	1,000,000
Business deductions	(2,000,000)
Net loss	(1,000,000)
Excess business loss	(750,000)
Revised net loss	(250,000)
NOL carryback	N/A
NOL carryforward	(750,000)

Excess Business Loss Limitation

- Partnerships and S corporations:
  - The limit on excess business losses is applied at the partner or shareholder level
- Significant change from existing law and places new limitations on active business losses of individuals (somewhat similar to passive loss rules)
  - Old Law – business losses recognized by individuals could reduce nonbusiness income (interest, dividends, capital gains) without limitation

Excess Business Loss Limitation

- Applies to the aggregate income and deductions from all of a taxpayer's trades or businesses.
  - Impact of married filing jointly with each spouse having separate trade/business?
- Limitation applies after the application of the passive loss rules.

Net Operating Loss Limitation

- Disallows carryback of NOLs
- Allows for the indefinite carryforward of NOLs
  - Old Law – carry back NOL 2 years and forward 20 years
- Effective for NOL arising in a taxable year ending after December 31, 2017

NET OPERATING LOSS LIMITATION

- NOL carryover can only offset 80 percent of taxable income without regard to new section 199A deduction
  - Old Law – no taxable income limit to usage of pre-2018 losses
- Pre-2018 losses will have to be tracked separately from post-2017 losses

Net Operating Loss Limitation

- Example: For taxable year 2018, individual has a taxable income of $1,000,000. Individual also has a NOL carryforward of $1,000,000. How would this be handled under old/new tax law?

Net Operating Loss Limitation

Pre-2018 tax law

Gross income	1,000,000
NOL carryforward	(1,000,000)
Net income	-

Net Operating Loss Limitation

Post-2017 tax law

Gross income	1,000,000
NOL carryforward: $1,000,000 X 80%	(800,000)
Net income	200,000
NOL carryforward to subsequent years	200,000

Changes to the Historic Tax Credit

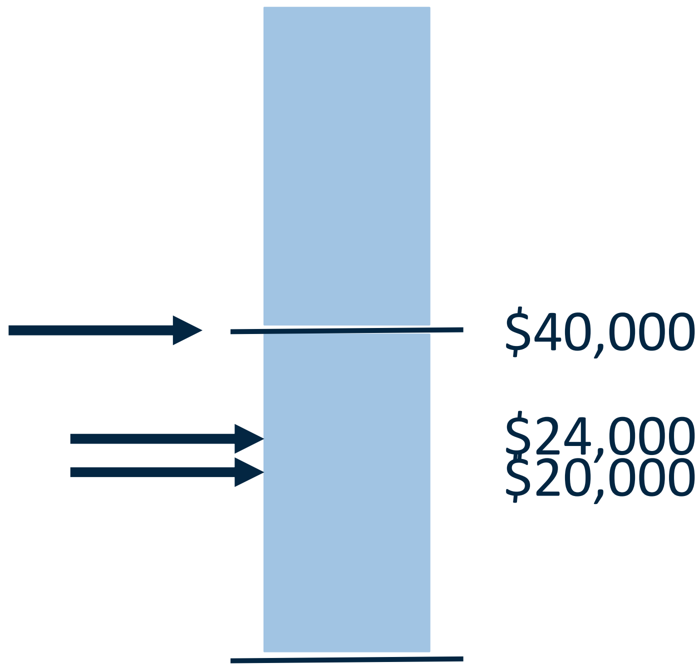
- 10 percent non-historic credit has been repealed
- 20 percent was retained and altered
  - HTC must be taken ratably over five years and cannot be used against the BEAT tax
  - Credit begins in the year the building is placed in service
  - Transition rule for QREs (potential for building to be grand-fathered)
- Impact to Pricing – reduction of 10 to 15 cents paid per credit

Income Averaging

- Introduced by the Consolidated Appropriations Act (omnibus spending bill)
- The bill also increased annual LIHTC allocations by 12.5% over the next four years
- New minimum set-aside
  - Old law includes 20/50 and 40/60 set-aside
  - Allows owners to designate imputed income limitations on units in the development, the average of which can't exceed 60% of AMI

Income Targeting

- Imputed income limitations



Income Averaging

- Designated imputed income limitations:
  - 20 percent
  - 30 percent
  - 40 percent
  - 50 percent
  - 60 percent
  - 70 percent
  - 80 percent

Income Averaging

- Individual households' incomes are not taken into account when determining the income averaging for a development
- Rather, the imputed income limits are determined by the development owner, the average of which must be equal to or less than 60% of AMI

Examples…

INCOME AVERAGING

- Development A is composed of 10 units. 6 units are market rate and 4 units are designated to be low-income. The owner intends to elect the Average Income for its minimum set-aside test. In order to do so, the owner designates the four units as follows:
  - One unit – 20% AMI
  - Two units – 80% AMI
  - One unit – 60% AMI

Income Averaging

- Test 1:
  - 4 rent restricted units out of 10 = 40%
- Test 2:
  - 20% * 1/4
  - 80% * 2/4
  - 60% * 1/4
  - Average of above = 60%

Income Averaging

- Development A is composed of 10 units. 6 units are market rate and 4 units are designated to be low-income. The rent-restricted units are occupied by households at move-in with the following incomes:
  - Unit 1: 75%
  - Unit 2: 41%
  - Unit 3: 55%
  - Unit 4: 59%
  - Average: 58%

Income Averaging

- Individual households' incomes are not taken into account when determining the income averaging for a development
- Rather, the imputed income limits are determined by the development owner, the average of which must be equal to or less than 60% of AMI

Income Averaging

- Test 1:
  - 4 rent restricted units out of 10 = 40%
- Test 2:
  - 80% * 1/4
  - 50% * 1/4
  - 60% * 2/4
  - Average of above = 63%

- Next available unit rule
  - If the income of a tenant in a rent-restricted unit increases above 140% of the rent limit for that household type, the property is required to rent the next comparable or smaller market-rate unit to a LIHTC tenant
  - If the next available unit is not rented to a LIHTC tenant, the unit housing the tenant over 140% of the rent limit is no longer considered a LIHTC unit and the applicable fraction goes down
  - If the applicable fraction goes down, you now cannot claim credits on that unit

Income Averaging

- Next available unit rule – Income averaging – Part 1
  - Two buckets:
    - Units designated at or below 60%
    - Units designated above 60%
  - For bucket one, regardless of the income designation (20, 30, 40, 50, 60), the tenant's income would need to exceed 140% of the 60% limit to trigger the NAU rule
  - For bucket two, the tenant's income would need to exceed 140% of the income target (70% or 80%)

Income Averaging

- Next available unit rule – Income averaging – Part 2
  - If Part 1 triggers the NAU rule:
    - If there is NOT a vacant unit comparable or smaller in the building, do nothing
    - If there is a vacant unit:
      - If already a LIHTC unit, continue renting unit based on designation
      - If a market rate unit, rent to a tenant meeting the income designation of the over-income unit

Income Averaging

- Next available unit rule – Income averaging – Part 3
  - Not including the units failing the 140% test, is the applicable fraction what it needs to be to claim credits and does the property meet the income averaging test?
    - If no, complete Part 2 again until yes
    - If yes, the NAU can be rented to a market rate tenant
    - The tenant over 140% can now be converted to a market rate unit

- Other Considerations
  - Election is available after March 23, 2018
  - Minimum set-aside as it applies to multiple building election
  - Existing properties already taking credits are not eligible for IA
  - What about properties which have been awarded but have not made the minimum set-aside election?
  - What about resyndicated properties and the extended use agreement?
  - Can owners change the unit designation as necessary while still complying with the IA rule?
  - How does IA apply to private activity bond financing?

Opportunity Zone

- Economic Development Tool
  - Designed to spur economic development and job creation in distressed communities
  - Designated by the governor
- Qualified Opportunity Fund
  - Eligible taxpayer self certifies
  - Must hold at least 90 percent of assets in qualified opportunity zone property
  - Must pay penalty for each month it fails to meet the investment requirement

Opportunity Zone

- Up to nine year deferral on capital gains tax if those gains are invested in Qualified Opportunity Funds
- 180 day period to investment in Qualified Opportunity Fund from date of gain
- Only have to invest capital gain (not total gross proceeds from sale)

Opportunity Zone

- Gain must be recognized on the earlier of:
  - December 31, 2026, or
  - The date the investment is sold/exchanged
- Long-term investment provision
  - Step-up in basis of up to 10% if the property is held for at least 5 years
  - Additional 5% step-up in basis if the property is held for at least 7 years (15% step-up)

Opportunity Zone

- No gain recognition on excess gain
  - 100% tax-free gain if investment is held for at least 10 years over the original deferred gain

Examples…

ABC APARTMENTS - A HYPOTHETICAL APARTMENT DEVELOPMENT
STATEMENT OF PROJECTED ANNUAL LIMITED PARTNER BENEFITS
USING HYPOTHETICAL DEVELOPMENT COST, REVENUE AND EXPENSE ASSUMPTIONS
9% LOW INCOME HOUSING TAX CREDIT EXAMPLE

YEAR	CAPITAL CONTRIBUTION	TAXABLE INCOME (LOSS) (A)	TAX SAVINGS 21% (B)	CASH FLOW (A)	TAX CREDITS (C)	TOTAL BENEFIT	AFTER TAX ANNUAL RETURN ON INVESTMENT	AFTER TAX NET CASH INVESTMENT (BENEFIT)
Year 0	15,766,500		0		0	0	0.00%	15,766,500
Year 1	0	(1,114,425)	234,029	11,235	1,753,412	1,998,676	12.68%	13,767,824
Year 2		(1,354,672)	284,481	11,280	1,753,412	2,049,173	13.00%	11,718,651
Year 3		(1,081,224)	227,057	11,303	1,753,412	1,991,772	12.63%	9,726,879
Year 4		(909,785)	191,055	11,301	1,753,412	1,955,768	12.40%	7,771,111
Year 5		(889,760)	186,850	11,273	1,753,412	1,951,536	12.38%	5,819,575
Year 6		(757,275)	159,028	11,219	1,753,412	1,923,660	12.20%	3,895,916
Year 7		(640,016)	134,403	11,138	1,753,412	1,898,953	12.04%	1,996,963
Year 8		(637,214)	133,815	11,026	1,753,412	1,898,253	12.04%	98,710
Year 9		(633,830)	133,104	10,884	1,753,412	1,897,400	12.03%	(1,798,691)
Year 10		(630,796)	132,467	10,710	1,753,412	1,896,589	12.03%	(3,695,279)
Year 11		(627,168)	131,705	10,502		142,207	0.90%	(3,837,486)
Year 12		(623,880)	131,015	10,258		141,273	0.90%	(3,978,759)
Year 13		(619,986)	130,197	9,977		140,174	0.89%	(4,118,933)
Year 14		(616,418)	129,448	9,658		139,106	0.88%	(4,258,040)
Year 15		(612,232)	128,569	9,298		137,867	0.87%	(4,395,907)
Disposition		(3,856,757)	809,919	45,913		855,832	5.43%	(4,551,111)
	$15,766,500	($15,605,438)	$3,277,142	$206,975	$17,534,122	$21,018,239		

Internal Rate of Return 5.09%

Opportunity Zone

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STATEMENT OF PROJECTED ANNUAL LIMITED PARTNER BENEFITS
USING HYPOTHETICAL DEVELOPMENT COST, REVENUE AND EXPENSE ASSUMPTIONS
9% LOW INCOME HOUSING TAX CREDIT EXAMPLE

YEAR	CAPITAL CONTRIBUTION	TAXABLE INCOME (LOSS) (A)	TAX SAVINGS 21% (B)	OPPORTUNITY ZONE TAX SAVINGS (COSTS) (D)	CASH FLOW (A)	TAX CREDITS (C)	TOTAL BENEFIT	AFTER TAX ANNUAL RETURN ON INVESTMENT	AFTER TAX NET CASH INVESTMENT (BENEFIT)
Year 0	15,766,000		0	3,310,860		0	3,310,860	21.00%	12,455,140
Year 1		(1,114,425)	234,029		11,235	1,753,412	1,998,676	12.68%	10,456,464
Year 2		(1,354,672)	284,481		11,280	1,753,412	2,049,173	13.00%	8,407,291
Year 3		(1,081,224)	227,057		11,303	1,753,412	1,991,772	12.63%	6,415,519
Year 4		(909,785)	191,055		11,301	1,753,412	1,955,768	12.40%	4,459,751
Year 5		(889,760)	186,850		11,273	1,753,412	1,951,536	12.38%	2,508,215
Year 6		(757,275)	159,028		11,219	1,753,412	1,923,660	12.20%	584,556
Year 7		(640,016)	134,403		11,138	1,753,412	1,898,953	12.04%	(1,314,397)
Year 8		(637,214)	133,815	(2,814,231)	11,026	1,753,412	(915,978)	-5.81%	(398,419)
Year 9		(633,830)	133,104		10,884	1,753,412	1,897,400	12.03%	(2,295,820)
Year 10		(630,796)	132,467		10,710	1,753,412	1,896,589	12.03%	(4,192,408)
Year 11		(627,168)	131,705		10,502		142,207	0.90%	(4,334,615)
Year 12		(623,880)	131,015		10,258		141,273	0.90%	(4,475,888)
Year 13		(619,986)	130,197		9,977		140,174	0.89%	(4,616,062)
Year 14		(616,418)	129,448		9,658		139,106	0.88%	(4,755,169)
Year 15		(612,232)	128,569		9,298		137,867	0.87%	(4,893,036)
Disposition		(3,856,257)	809,814		45,913		855,727	5.43%	(5,048,135)
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	$15,766,000	($15,604,938)	$3,277,037	$496,629	$206,975	$17,534,122	$21,514,763		
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Internal Rate of Return 7.39%

BEAT Tax

- Corporate AMT tax was repealed
- BEAT Tax was introduced for international corporations
  - Logical extension of the US move to a territorial tax system
  - Intended to impose a minimum tax on international corporations
- Only international corporations that have at least $500 million in average annual gross receipts for the last three years

BEAT Tax

- Special treatment until 2025 for R&D, LIHTC, and Renewable Energy Credits
  - Up to 20% of credits do not reduce BEAT liability
- No special treatment for HTC and New Market Tax Credit
- New law does not provide for any carryover – credits are permanently lost