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Impact of Tax Reform on Low Income Housing Tax Credit Transactions

Welcome and Introductions

Molly Bryson, Esq.
Ballard Spahr LLP

Maia Shanklin Roberts, Esq.
Ballard Spahr LLP

Amy L. Broadwater, CPA
RubinBrown LLP

Emily Cadik
Enterprise Community Partners, Inc.

Darren Swanson
Red Stone Equity Partners

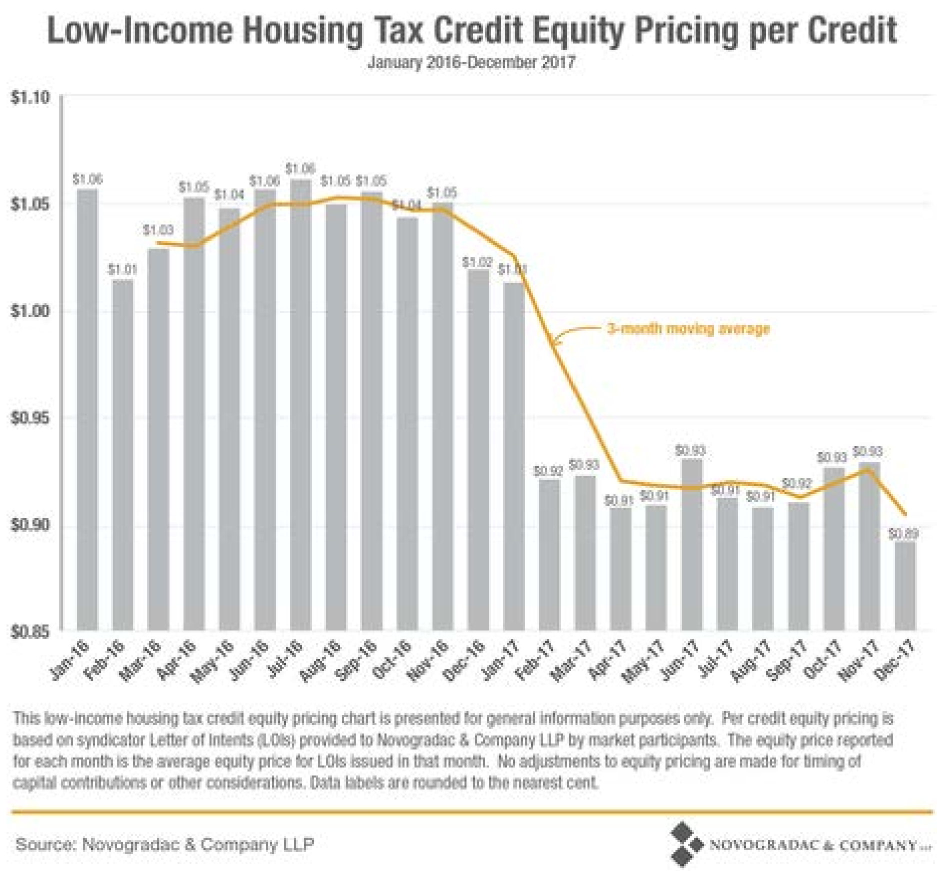
Brian Fishback
Red Stone Equity Partners

Tax Reform Provisions Impacting Affordable Housing

- Retained Low-Income Housing Tax Credit
  - Earlier proposals to modify Housing Credit were not included in final bill
- Retained Private Activity Bonds, including Multifamily Housing Bonds
  - Housing Bonds provide critical financing to roughly half of all Housing Credit developments
- Lowered top corporate tax rate from 35 to 21 percent
- Created Base Erosion and Anti-abuse Tax (BEAT)

Impact of Tax Reform on Affordable Housing

- Despite retaining core affordable housing programs, tax reform will significantly impact production
- **14 percent** reduction in Housing Credit value
- **235,000 fewer** affordable homes to be built or preserved over the next decade



What's next after tax reform?

- Expand and strengthen Housing Credit by advancing Affordable Housing Credit Improvement Act
  - Increase in resources needed to address vast and growing shortage of affordable housing ***and*** to restore affordable housing production in light of lower corporate tax rate
- Continue education around the connection between Housing Bonds and the Housing Credit
- Address Base Erosion and Anti-abuse Tax issues and other technical corrections?

Affordable Housing Credit Improvement Act

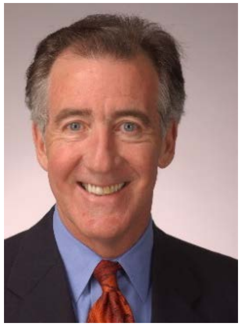
- Senate version includes 50 percent increase in Housing Credit allocation, phased in over five years
  - Prior to tax reform, this would have produced400,000 more affordable homes over the next decade
- Nearly two dozen provisions to strengthen Housing Credit and Bonds, including:
  - Minimum 4% Housing Credit rate
  - Income averaging
  - Basis boost for extremely low-income households

Affordable Housing Credit Improvement Act

- Senate version introduced by Sen. Maria Cantwell and Sen. Finance Committee Chairman Orrin Hatch (S. 548)
- 23 co-sponsors
  - 10 Republicans
  - 13 Democrats (with nearly 20 queue to sign on)


Affordable Housing Credit Improvement Act

- House version introduced by Reps. Pat Tiberi and Richard Neal (H.R. 1661)
- Rep. Curbelo (R-FL) new lead sponsor
- 127 co-sponsors
  - 64 Republicans
  - 63 Democrats
  - More than one-fourth of House



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Affordable Housing Credit Improvement Act

- Strategy for advancing the Affordable Housing Credit Improvement Act
  - Though the bill was not included in tax reform, there is still bipartisan interest in advancing it in 2018
  - Potential vehicles: omnibus bill or anything with a tax component
  - Increase likelihood that the bill is included in the next tax legislation by:
    - Continuing to build co-sponsorship
    - Asking current co-sponsors and other supporters to weigh in with leadership urging them to advance it this year
  - Next tax bill will have to be bipartisan in order to pass, so we are reaching out to both Republicans and Democrats

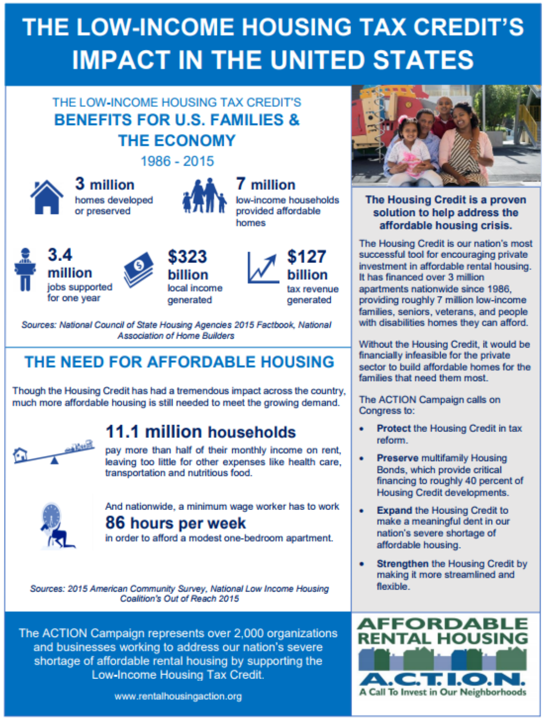
Getting Involved

ACTION Campaign

- More than 2,100 businesses and organizations advocating on behalf of the Housing Credit and Bonds
- Visit www.rentalhousingaction.org for advocacy resources and updates

Affordable Housing Tax Credit Coalition

- Advocating on behalf of the Housing Credit since 1988
- www.taxcreditcoalition.org



C Corporation Tax Rates/Provisions

- Tax rate is 21% on all types of income
- Corporate AMT is repealed
- Base erosion and anti-abuse tax (BEAT) is created
  - Foreign-based parents of domestic C corporations
  - LIHTC is allowed as a reduction to 80% of this tax through 2025
    - Only 80% of your LIHTCs can be utilized to offset the BEAT
    - There is no carryforward of the unused 20%

Depreciation Provisions – Bonus Depreciation

- Bonus depreciation percentage for property acquired
  - 100% for property placed in service after September 27, 2017 and before 2023
  - 80% for property placed in service in 2023
  - 60% for property placed in service in 2024
  - 40% for property placed in service in 2025
  - 20% for property placed in service in 2026
- Property that is acquired prior to September 28, 2017, but placed in service after September 27, 2017, remain subject to existing bonus depreciation percentages (50% - 2017; 40% 2018; 30% - 2019)
- Under the new law, the acquisition date for property acquired pursuant to a written binding contract is the date of such contract
- Qualified property includes used property acquired for purchase as long as the acquiring taxpayer had not previously used the acquired property and the property is not acquired from a related party

Depreciation Provisions - Applicable Recovery Period for Real Property

- ADS recovery period for residential rental property is reduced from 40 years to 30 years
- Any real property trade or business that elects out of the interest deduction limitation (discussed on next set of slides) must depreciate building property under ADS
  - Residential 30 years
  - Non-residential 40 years
- Effective for assets placed in service after 2017
- May still want to make Section 168(h)(6) elections due if the partnership wants to take bonus depreciation

Limitation on the Deduction of Net Interest Expense

- Net interest expense deduction will be limited to 30% of adjusted taxable income
- Business interest is defined as any interest paid or accrued on indebtedness property allocable to a trade or business
- Adjusted taxable income is calculated as taxable income adjusted for the following items:
  - Investment interest income/expense
  - Business interest income/expense
  - Non trade or business gains
  - 20% deduction for passthrough income
  - Non trade or business deduction/loss
  - Net operating loss deduction
  - Depreciation, amortization and depletion (only through 2021)

Limitation on the Deduction of Net Interest Expense (continued)

- Businesses with average annual gross receipts of less than $25 million are exempt from this limitation, except for a tax shelter. Most tax credit investments will be considered tax shelters as defined under the Internal Revenue Code.
- Real Property Trade or Businesses can elect out of this interest limitation but must use the ADS lives for depreciating nonresidential real property, residential real property and qualified improvement property.
- This disallowance occurs at the filer level and not at the taxpayer level.
- Disallowed interest expense can be carried forward indefinitely
- Effective for tax years beginning after December 31, 2017

Limitation on the Deduction of Net Interest Expense (continued)

- Issues with existing projects
  - This interest limitation still applies because it does not relate to debt instruments issued
  - Real estate businesses can still elect out but the residential rental property and the nonresidential rental property must be depreciated over the ADS recovery period at the time the election is made
  - One area of uncertainty is how to treat the change to ADS recovery periods. The IRS is unsure as to whether the net book value of the asset at the time of the change is then depreciated over the net remaining depreciable life or if there will be an income recognition requirement related to "excess" depreciation taken in prior years.
  - A possible anomaly exists with the new tax law: the ADS life for residential rental property placed in service prior to January 1, 2018 is still 40 years instead of 30 years.
  - Accordingly, if an existing LIHTC partnership that has placed a building in service prior to 2018 desires to avoid the interest deduction limitation of new Section 163(j) by electing treatment as an electing real property trade or business, it will have to convert depreciation of its residential rental property from 27.5 to 40 year depreciation.

Repeal of Technical Terminations

- H.R. 1 repeals the technical termination rules in current Code Section 708(b)(1)(B).
- Depreciation will not reset upon sale of a partnership interest
- Step-up adjustments and mandatory step-down adjustments will still be recorded
- Applies to partnership tax years beginning after December 31, 2017

Historic Tax Credit Changes

- Historic Rehabilitation Credits
  - Repeal of the 10% credit for per-1936 buildings
  - 20% credit remains, but the credit will be claimed ratably over 5 years
    - Ratably has not yet been defined
  - Transition rule for qualified rehab expenditures incurred with respect to a certified historic structure that was owned or leased at all times on and after January 1, 2018.

Tax Reform Impact on LIHTC Deals

- Alleviated major uncertainty experienced throughout 2017
  - Experienced brief pause while investors analyze appetite

- Created new structural and pricing considerations
  - Depreciation effectively over 30 years if LIHTC Partnership makes Real Property Trade or Business election
  - 100% Bonus Depreciation

- Capital account implications on existing deals
  - Depreciation and tax rate changes will impact future Year 15 transactions

Implications on 4% Transactions

- Less ability to slow down investor's capital account from going negative

- Potential structure issues if previously planning for 40 year depreciation

- Rising interest rate environment impacts bridge loan analysis

Implications for Non-Profits

- 168(h)(6) Election
  - Bonus depreciation NOT available on Tax-Exempt Use property
  - Non-profit sponsors to weigh pros/cons of being taxed on partnership fees vs pricing difference relative to bonus depreciation

- ROFR/Purchase Option
  - Exit tax liability potentially increased by faster depreciation
  - 21% tax rate reduces exit tax implications (for now)

Factors Affecting Credit Pricing

- Corporate tax rate drop from 35% to 21%
  - In theory, makes State Credits more valuable

- 100% Bonus Depreciation
  - Only material yield offset to the tax rate drop
  - Expect to see adjusters if pursuing aggressive terms/cost segregation studies

- Historic Credits
  - 5 year delivery = $0.10-$0.15 pricing hit
  - If “grandfathered” delivery, anticipate adjusters

Factors Affecting Credit Pricing

- CRA Reform
  - TBD, but sounds like it is on the horizon

- BEAT
  - A few investors out of the market
    - Fannie/Freddie back in (limited capacity)
  - Doesn’t seem to be as big of an issue as anticipated (yet)

- Opportunity Zones
  - Potential to be “twinned” with LIHTC/HTC/NMTC
  - Awaiting zone designation and guidance from Treasury

Partnership Audit Rules

- Adjustments taken into account at Partnership level, not by the individual
- Elevates the role of the "Partnership Representative"
- Adjustments reflect in year of audit, not year under review
  - If partners have changed, those who pay price may be different from those who reaped benefit
- Additional issues to be considered as a result of proposed rules

Questions?

Follow-up to today's presentation will be posted on our blog *Housing Plus* at **www.housingplusblog.com**.

A copy of these slides and a recording of the presentation will be available at **www.ballardspahr.com/housing.**

Upcoming Events

Conferences

- *Ballard Spahr | CSG Advisors 8th Annual Western Housing Conference*, April 13, Denver
- *Ballard Spahr National Housing Symposium*, November 9, Washington, D.C.

Webinars

- *Update on HOTMA Reforms*, March 13
- *Mod-Rehab RAD Conversions*, May TBD

Contacts

Thank you for your time!

Amy L. Broadwater | 615.480.2871 | amy.broadwater@rubinbrown.com

Brian Fishback | 704.200.9513 | Brian.Fishback@RSEquity.com

Darren Swanson | 704.200.9508 | Darren.Swanson@RSEquity.com

Emily Cadik | 202.403.8015 | ecadik@enterprisecommunity.org

Maia Shanklin Roberts | 202.661.7667 | ShanklinRobertsM@ballardspahr.com

Molly Bryson | 202.661.7638 | brysonm@ballardspahr.com