Section II
Production

Chapter 12
LIHTC and other Tax Credit Program Guidance

12.1 Introduction

The Low Income Housing Tax Credit (LIHTC) program was enacted as part of the Tax Reform Act of 1986 and is administered by the Treasury Department and State Housing Finance Agencies (HFAs). In July 2008, the Housing and Economic Recovery Act (HERA) was enacted which made changes to FHA programs to facilitate the use of FHA-insured mortgages with LIHTC developments.

This chapter outlines the policies and procedures to follow when underwriting and reviewing FHA mortgage insurance applications referenced under Title II of the National Housing Act with tax credits. Standard processing of applications ~~apply~~applies except as modified below as well as within Production, Chapters 5, 9 and 11 of this Handbook.

All provisions of this Handbook applicable to LIHTC are also applicable to Historic and New Markets tax credit equity projects, to the extent consistent with the Section 232 program.

12.2 Program Guidance

A. **Use of Tax Credits with the FHA-Insured Mortgage:**

1. The Firm Application for ~~any~~a LIHTC project should ~~generally~~ include evidence of the LIHTC award, allocation or application. ~~However,~~ LIHTC allocation timing varies by state and in some cases FHA applications must be submitted before final allocations of tax credits can be secured. Accordingly, other evidence is allowable, ~~for example~~such as the state agency bond cap allocators' assurances and written procedures stating that bond cap remains available for the period in question~~, that~~; an application has been submitted for the project in question, or that allocations are obtainable in the time available, etc., in the case of 4% LIHTC allocations. The application may qualify for the lower MIP LIHTC rate if it has existing LIHTC affordable use restrictions on the title at Initial Loan Closing. The LIHTC need not be a new issuance for the lower rate.

2. Government tax credits, combined with any secondary financing and grants, may be used to cover up to 100% of the equity requirement. ~~Regarding~~For secondary financing, see requirements and limitations in Production, Chapter~~ 3, at~~ 3.15.

3. Secondary financing, grants, and government tax credits may also be used to finance non-mortgageable costs. Such funds covering non-mortgageable costs, when added to the FHA-insured mortgage and required equity contribution, may exceed 100% of the project's Fair Market Value (FMV) or Replacement Cost.

4. Non-mortgageable costs or replacement cost items required to complete the project may be included in the transaction with supporting documentation, subject to ORCF approval.

5. Publicly Funded Loans or Public Debt. Loans funded with HOME Funds or other federal, state or local public sources, as well as those funded by quasi-public agency programs, may be granted or lent directly to HUD's ~~borrower~~Borrower, or to the GP or sponsor of the ~~borrower~~Borrower, who will then loan it to HUD's borrower. All such sources will be treated as public secondary financing sources, and as such need not be included in the calculation of the total project cost limit applied to private secondary debt. However, none of these sources may be substituted for tax credit equity required by the pay-in schedule.

6. Tax~~-~~-Exempt Bonds/Take out by FHA Insured Permanent Debt. Tax credit projects are often financed with the "4%" tax credits allocated in conjunction with private activity bond volume cap. Taxable Ginnie Mae securities' yields and the resulting rates on FHA loans at times can be lower than tax~~-~~-exempt bonds and municipal bond-backed loan rates. Consequently, investment banks have developed an approach that combines taxable Ginnie Mae securities with short~~-~~-term, tax~~-~~-exempt bonds and **4%** LIHTC. This structure establishes several different accounts, along with a series of cash flow events between the various accounts upon a draw request. The tax~~-~~-exempt bonds are secured by cash collateral initially provided by the FHA lender's warehouse funds (or other funding sources, but not FHA-insured loan proceeds), which in turn are reimbursed with proceeds from the sale of Ginnie Mae-guaranteed securities. The tax~~-~~-exempt bonds are retired with the proceeds of the bond collateral account when the project is placed into service.

   This structure allows the ~~borrower~~Borrower to avoid higher loan rates that exist when the loan funding source consists exclusively of tax~~-~~-exempt bonds, and still take advantage of the 4% LIHTC equity. This bond financing structure is generally acceptable to HUD, but each transaction must be reviewed by HUD for programmatic and legal sufficiency, including the review of specific transaction documents.

   NOTE: FHA-insured loan proceeds shall not be used to serve as collateral for the bonds, and they may not be paid to the bond trustee or sent to other accounts to facilitate issuance of the bonds. This is a statutory prohibition that may not be waived, as FHA-insured loan proceeds are only permitted to directly finance the relevant activity authorized under the applicable section of the National Housing Act. To ensure statutory compliance regarding the use of FHA-insured loan proceeds, HUD requires lenders to sign and submit the "Lender Certification for Tax~~-~~-Exempt Bond and 4% Low Income Housing Tax Credit Transactions" for financings structured in this manner.

7. Borrowers using LIHTC or other government tax credit programs must demonstrate successful experience in developing and owning comparable regulated properties.

8. If a tax credit syndicator is identified, the Lender's Underwriter will also need to provide a brief overview and analyses of the entity. Typically, a tax credit syndicator is an investor intermediary with only a limited ongoing obligation to LIHTC rental properties. Nevertheless, the syndicator's liquidity, track record, asset management and monitoring capability and ability to perform on its commitment to provide equity to the Borrower after Initial Closing is a material issue for the experience and creditworthiness analysis of the tax credit investor/LP.

9. For LIHTC projects with a funded working capital reserve held by the partnership (even though controlled by the syndicator or investor and not by HUD or the Lender), the funded reserve will be credited towards the increased construction reserve requirement, although the Lender~~-~~-controlled account must still meet the 2% working capital escrow requirement.

10. For LIHTC projects with a funded operating deficit reserve held by the partnership (even if controlled by the investor and not by HUD or the Lender), the funded reserve will be credited towards the reserve requirements of the mortgage, although the Lender controlled account must still meet what the appraisal and underwriting analysis determines to be an appropriate operating deficit amount.

B. **Tax Credit Equity Bridge Loans:**

Tax credit equity syndicators or investors (which may, subject to the restrictions in Section 12.2(D) of this Chapter, have an identity of interest with Lender) may make equity bridge loans to tax credit projects during the construction or substantial rehabilitation period before the property's placed-in-service date, as defined by the applicable tax credit program. Bridge loans may be used by tax credit investors to defer the pay-in of equity during a project's development and stabilization phases, thereby increasing the return on equity. However, at final closing, all funds needed to meet the ~~borrower's~~Borrower's cash contribution must be in the transaction so the sources and uses will balance and the investors will pay in the equity to retire the equity bridge loan.

The bridge loan may be the obligation of one or more of the investors or other upper~~-~~-tier partners to the ownership entity (e.g~~.~~.., the limited or general partners), or an obligation of the project ownership entity/single-asset mortgagor itself. In addition, the following conditions must be met:

1. The equity bridge loan may not be secured by a lien on the real estate or on any other real or personal property that is collateral for the FHA insured loan, as defined in the Security Instrument, although the equity bridge loan may be secured with a pledge of tax credits and/or of limited partners' or investor members' interests in the project's ownership entity;

2. The equity bridge loan must be non-recourse to the Borrower, and the bridge lender shall have no claim even in an event of default against the Borrower, the Project, FHA mortgage loan proceeds, or any reserve or deposit made with the FHA Lender, or otherwise required by HUD;

3. In the event HUD acquires title to the Project by foreclosure or deed in lieu of foreclosure, the bridge loan documents shall automatically terminate, and the Borrower shall be released of all of its obligations with respect to the equity bridge loan;
4. The obligation must be evidenced by a promissory note;

5. The term of the note may last through the construction or rehabilitation period but must be paid in full at or prior to final endorsement of the Note.

6. At application, or as soon as the need for a bridge loan is known, the lender must submit a term sheet describing the key terms of the bridge loan, as well as a certification that a) the loan will be secured only by a pledge of partnership interests or tax credit benefits and not by the project, and b) that the bridge lender will have no claim against the mortgaged property, mortgage proceeds, any reserves or deposits, or against the rents or other income from the property for repayment of the bridge loan.

7. Bridge loans for other purposes, (i.e~~.~~., that are not used to advance equity in tax credit projects) are described in Chapter 3.

C. **Tax Credit Equity Contribution:**

1. ORCF requires that an appropriate amount of the tax credit equity be invested in the project and be applied to ORCF-approved items at the time of initial closing. The amount deemed by ORCF to be sufficient for such purposes will depend on the circumstances of each transaction~~,~~ but must be an amount that assures an ongoing relationship between the Borrower and the tax credit syndicator or investor.

2. The initial installment of equity must be an amount that is equal to or exceeds twenty percent (20%) of the total equity that will be available for the project. If less than 20% is proposed, the Lender must submit a request for ORCF review and approval. ORCF will review the justification submitted to

determine if the lesser amount is appropriate as an initial investment of equity.

3. The Commitment for Mortgage Insurance will contain, among other special conditions, a requirement for evidence satisfactory to ORCF of an agreement that binds the investor to timely and periodically pay the Borrower tax credit equity to contribute to the completion costs, in the aggregate amounts shown on the Applicant/ Recipient Disclosure/Update Report (Form HUD-2880). An equity pay-in schedule, with actual total equity and net-equity amounts, must be included as a special condition and attachment to the Firm Commitment for all tax credit Projects. This schedule will be used as a method of checking proposed disbursement schedules.

4. The actual amount of the initial equity investment must be reflected in the Firm Commitment as a special condition with the requirement that the initial installment must be expended on the initial requisition at Initial Closing.

5. After the first installment of tax credit equity is distributed at initial closing, ~~the~~ subsequent contributions shall be made at a time and in a manner during construction to ensure that the underwriting requirements in the Firm Commitment are maintained and met for actual costs. To maintain the appropriate balance of tax credit equity and mortgage loan proceeds, at each infusion of tax credit equity, those funds may need to be utilized before the next disbursement of mortgage loan proceeds.

D. **Sponsor's Continuing Commitment:**

1. To the extent consistent with the Section 232 program, the application must include a *Letter of Commitment* to fund the required equity from a tax credit equity syndicator or investor. This *Letter of Commitment* must specify the equity amount, pay-in schedule, and other relevant details such as conditional benchmarks so that HUD and the Lender can ensure sufficient equity in a manner that meets HUD's requirements. The Lender may also make the determination to require additional documentation (e.g~~.~~., financial statements, etc.) of a syndicator or investor.

2. The Lender must focus on and evaluate the tax credit syndicator's or the direct investor's financial strength, experience, reputation, and asset management capabilities, if they have the majority ownership interest in the Borrower entity. Evaluating the syndicator is important because investors expect syndicators to support transactions that have cash flow problems or replace nonperforming general partners. In addition, the syndicator must typically assess the appropriate amounts of reserves at both the property and fund levels and must perform certain asset management functions.

E. **Identity-of-Interest:** An affiliate of the Lender can own up to a 25% percent interest in the investor limited partnership ~~interests~~ (or investor LLC ~~membership interests~~) entity of the Borrower, under the following conditions:

1. In all instances where there is an identity of interest or affiliation between the Lender and the tax credit equity syndicator or investor, the loan must be processed, underwritten, and approved by the Lender staff without involvement by the affiliated equity staff.

2. The affiliated tax credit equity syndicator or investor can hold no more than a 25% interest in the limited partnership entity (or an equivalent percentage if owned as an LLC) of the Borrower after the project's placed-in-service date. During the construction or rehabilitation period before the property's placed-in-service date, the tax credit equity syndicator or investor may make an equity bridge loan that complies with Section 12.2.B. After the placed-in-service date, the affiliated tax credit equity syndicator or investor may not hold an equity bridge loan note and may not own more than a 25% interest in the limited partnership entity of the Borrower.

3. ORCF must ensure that the affiliated tax credit equity syndicator or investor does not improperly influence the Lender on a LIHTC project. Therefore, the Lender and the affiliated tax credit equity syndicator or investor must provide ORCF with a specific Representations and Warranties on applications submitted for each LIHTC project.

    a. **The Lender's Representation and Warranty must state:**
        i. No officer or employee of ________________________ (insert the name of affiliated tax credit syndicator or investor) (Syndicator) or any director or parent thereof will have any loan-specific or decision making control or influence in ________________'s (insert the name of Section 232 Lender) (Lender) underwriting of the FHA-insured mortgage except by providing factual information to _____________________ (insert the name of Lender) in the same manner as would be provided by an unaffiliated syndicator).
        ii. __________________________ (insert the name of Lender) will not condition its agreement to provide such financing on _______________ (insert the name of affiliated tax credit equity syndicator or investor) (Syndicator) being selected as the tax credit equity syndicator or investor for the project to be financed by the FHA-insured mortgage.
        iii. ____________________ (insert the name of the Lender) will notify HUD promptly, in writing, during application processing of any change or event which causes the foregoing Representation or Warranty to be materially untrue or inaccurate.

    b. **The Lender's affiliated tax credit syndicator or investor's Representation and Warranty must state:**
        i. In the regular course of its business, it syndicates or invests in tax credit equity investments in assisted living affordable housing projects.
        ii. With respect to any project loan that is to be underwritten by __________________(insert name of Lender) and in which ________________(insert name of affiliated tax credit equity

syndicator or investor) (Syndicator) intends to make an equity investment or sell equity to other investors:

1. No officer or employee ________________(insert name of Lender) will have any loan-specific control or influence in _____________________'s (insert name of affiliated tax credit equity syndicator or investor) (Syndicator) processing of the sponsor's application for tax credit equity syndication or investment except by providing factual information to ___________ (insert the name of affiliated tax credit equity syndicator or investor) (Syndicator) in the same manner as would be provided to an unaffiliated Lender.
2. ___________________ (insert the name of affiliated tax credit equity syndicator or investor) (Syndicator) will not condition its commitment to syndicate or invest in the project equity on debt financing for such project being provided by ___________ (insert the name of Lender).
3. Except during the interim period prior to the placed in service date during which _______________ (insert name of affiliated tax credit equity syndicator or investor) (Syndicator) may make an equity bridge loan to the project, neither __________________ (insert the name of affiliated tax credit equity syndicator or investor) (Syndicator) nor any affiliate or subsidiary thereof will hold greater than a 25% interest in the 99% investor limited partnership entity (or an equivalent percentage if owned as an LLC) of the Borrower.

4. The Representations and Warranties must include the following criminal warning language: ~~-~~"**WARNING**: ~~"*HUD will prosecute*~~Anyone who knowingly submits a false ~~*claims and statements. Convictions may result*~~claim or makes a false statement is subject to criminal and/or civil penalties~~.~~, including confinement for up to 5 years, fines, and civil and administrative penalties. (18 U.S.C. §§ 287, 1001, 1010, 1012; 31 U.S.C. §3729, 3802~~)"~~)."

F. **Subsidy Layering Review:** Tax credit equity solely in combination with FHA-insured debt is exempt (by the Housing and Economic Recovery Act of 2008 (HERA)) from a subsidy layering review. Beyond the FHA-insured debt, a subsidy layering review is required when other public funds are combined. In every case, regardless of the sources of supplemental public grant, loan, or equity funds, the Lender must review the Sources and Uses statements for both mortgageable and non-mortgageable funds to ensure costs are not being funded twice, and that costs funded directly or indirectly from mortgage proceeds are appropriate and necessary to complete the transaction.

G. **Tax Credit Regulatory Agreements**. In tax credit projects, certain IRS Section 42 obligations must be allowed to continue post-default. Generally, however, for the Tax Credit Land Use Restriction Agreement (LURA), and/or when public secondary financing with regulatory agreements or restrictive covenants are required, HUD requires the use of its standardized rider, Form HUD-94000B-ORCF, Rider to Security Instrument, LIHTC, indicating that in case of conflicts between a LURA or another restrictive covenant and FHA "program obligations," FHA requirements take precedence. Alterations of the rider that are once approved for certain jurisdictions may then be used as the template for that jurisdiction, with prior ORCF approval. **It is the lender's responsibility to draw attention to potential conflicts between FHA requirements and the LURAs or other restrictive covenants in the Firm application submission.** If they are not addressed in the Firm Commitment, the lender should assume the closing will be delayed.

12.3 Firm Commitment and Initial Closing

A. The Firm Commitment will include special Firm Commitment conditions to confirm and assure the Tax Credit Equity requirements stated in Section 12.2:

1. That the Commitment is subject to, and has been issued upon the reliance of, the receipt of Low Income Housing Tax Credit (Historic Tax Credits or New Market Tax Credits) syndication funds in the amount of $ _____ of which a $ ____ cash investment is required for mortgageable items including land and $ -_____ for HUD required escrows. The initial installment of funds allocated to mortgageable items must be provided prior to initial closing, with a disbursement agreement that evidences the timely infusion of funds required to pay for all project costs. All documents relating to the tax credit funds, including the Land Use Restriction Agreements, the final statement of sources and uses, and the final Applicant/ Recipient Disclosure/Update Report, must be reviewed and approved by ORCF prior to initial closing.

2. HUD's review and determination of acceptability and sufficient financial capacity is required for the tax credit investor(s). This investor entity and all principals are subject to Previous Participation clearance requirements, except to the extent limited liability corporate investors may submit an Identification and Certification of Limited Liability Investor Entities, found in Housing Notice H 2016-15 (or successors thereto), in lieu of other previous participation requirements. HUD approval of the final investor(s) must be accomplished prior to initial closing.

3. The Borrower's organizational documents must include a provision that prohibits any changes to the organization documents that affect the investor commitment without the written consent of the Lender and HUD.

B. **Initial Closing:** Prior to initial closing, HUD will review and approve all proposed closing documents to ensure compliance with all firm commitment obligations and Special

Conditions. Specific to loans involving tax credits, the initial closing documents must include:

1. A final detailed Sources and Uses statement of total development costs, reflecting any revisions to hard and soft costs as reflected on the firm commitment, Form HUD-92264a-ORCF. If any funding sources have changed, a revised Applicant/ Recipient Disclosure/Update Report is also required.

2. Tax credit syndicator and investor documents. The Partnership Agreement or other investor documents of the syndicator, including:
    a. Consolidated Certifications,
    b. Previous Participation certifications,
    c. Modified credit package to include current financial report or Annual Report, as applicable.

3. Evidence that the FHA-Insured Mortgage will be in first lien position with respect to all project collateral.

4. All documents shall include conflict language giving the HUD documents supremacy over other documents. Documents may not include indemnification provisions, except as otherwise permitted by outstanding HUD guidance.