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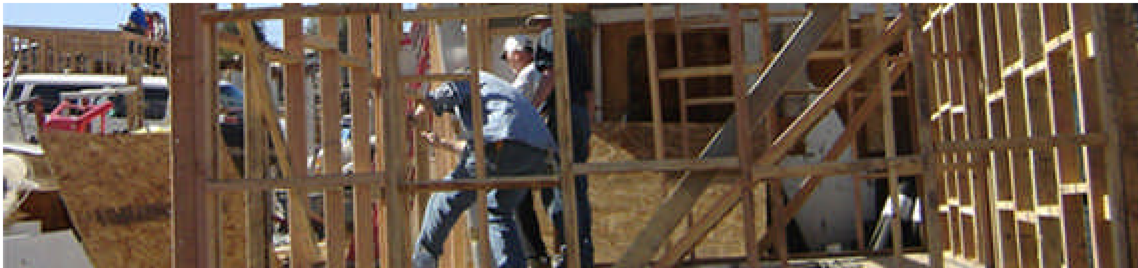

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Developers take advantage of low income housing development tax credits, but recent Third Circuit decision stirs controversy

Developers of multi-family apartment complexes geared to low- to moderate-income tenants are increasingly taking advantage of federal low-income housing tax credits (LIHTC) and, where available, their state counterparts, to finance such developments. Strictly speaking, LIHTC, which are allocated by state housing authorities, are not a form of financing. But frequently, a developer will partner with an equity investor interested in utilizing the tax credits, which are made available following the development or renovation of a qualified low-income housing development project. The credits come in two basic types: (a) more valuable 9 percent credits and (b) 4 percent credits, which typically are paired with a bond financing.

A LIHTC partnership is typically structured as a special-purpose entity controlled by the developer. The developer acts as general partner (sometimes with a non-profit entity as co-general partner if required for the issuance of the credits), and the equity investor acts as a limited partner. In general, the investor makes his or her equity available to the partnership in phases over the course of construction, with final equity payments made only upon completion of construction and lease-up of the project. As a result, a development typically needs construction financing from a traditional lender (and potentially other sources of financing such as HOME loan funds), until the equity proceeds are secured. The tax credits are then distributed to the partnership and allocated to the equity investor over a 10-year period beginning in the year the project is placed in service.

At Thompson Coburn, we have represented developers and lenders on such projects and have handled virtually all aspects of bond financings associated with 4 percent credit transactions.

A recent Third U.S. Circuit Court of Appeals decision (commonly known in the industry as the "Boardwalk" decision) has caused a firestorm of concern. In that decision, which involved historic rehabilitation tax credits (not LIHTC), the Third Circuit sided with the Internal Revenue Service (IRS) and held that the equity investor was not a true partner in the venture because the equity investor had no

"meaningful stake in the success or failure" of the project. Thus, the court held that the equity investor was not entitled to the tax credits at issue. The court's decision was incredibly fact-specific, thus suggesting that the holding may not have universal application, but the potential parallels for LIHTC transactions are striking, and many in the industry were surprised that the IRS directly challenged the manner in which most tax credit transactions, including LIHTC transactions, are structured. Nonetheless, LIHTC developers and major LIHTC lenders appear, at least for now, to have concluded that the risks associated with the "Boardwalk" decision are limited to historic tax credits, not LIHTC. At Thompson Coburn, we continue to monitor these issues closely.

If we can assist your business in achieving its goals with respect to a low-income housing development project, please contact your Thompson Coburn attorney or one of the attorneys listed below:

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