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Mercy Housing Closes First Deal With California Certificated Credits.

Mercy Housing California has closed a deal to use “certificated” state housing credits on its latest affordable housing development.

The transaction will help finance the development of the 180 West Beamer Street development in Woodland, Calif. The new 80-unit community will serve low-income families, with 32 units set aside for special-needs residents.

The deal with investor U.S. Bancorp Community Development Corp. (USBCDC) is believed to be the first transaction using certificated credits to close in the state.

The team faced the challenges that come with using a brand-new program, including creating new documents and working through deadlines and pay-in schedules that differed from those used in traditional credit transactions, according to Stephan Daues, Mercy Housing’s director of real estate division for the Sacramento region.

However, the approximately $30.7 million development was able to secure a higher price for its state housing credits that will eventually result in additional equity for the development of 180 West Beamer.

The deal comes after California leaders made changes to the law to allow for the certification of state low-income housing tax credits (LIHTCs) under a three-year pilot. Traditionally, LIHTCs are allocated to developers, who then sell them to an investor, usually in the form of a limited partnership interest. Certificated credits differ in that they are sold outright to investors who take no ownership interest in the development. This eliminates the impact of the state credits on an investor’s federal tax liability, allowing an investor to offer higher pricing.

State credits in California have recently sold for about 65 to 75 cents per dollar of credit, but officials think that the certificated credits could generate 90 to 95 cents per dollar of credit. That could result in about $20 million in additional equity to California projects and ultimately more affordable housing being built.

Under the new state program, participating developments must receive at least 80 cents per dollar of credit. For the Woodland project, an increase from 65 cents to 80 cents meant approximately $750,000 more in equity.

Mercy Housing, working with its partner New Hope Community Development Corp., received a reservation of approximately $5 million in state housing credits and $1.5 million in federal housing credits in 2016. Like many other developers, the team was hit with the double whammy of cost increases and lower LIHTC prices late last year, Daues says.

Federal LIHTC prices dropped sharply after the November election as the prospects of tax reform increased with Donald Trump in the White House and Republicans in control of the House and

Senate. Trump has called for slashing the business tax rate from 35% to 15% while members of Congress will likely be eyeing a rate in the 20% to 25% range. While a change in the tax rate does not affect the value of the tax credits themselves, it can impact depreciation and other tax losses that are part of the investment.

The California Tax Credit Allocation Committee (CTCAC) provided an opportunity for 2016 projects to exchange their state housing credits for certificated credits to raise additional financing. Mercy Housing and New Hope decided to make the move to raise additional financing for their development.

The deal was compelling to USBCDC for several reasons, according to Vihar Sheth, senior vice president, director of business development, affordable housing tax credit investments, at the firm, noting that the bank has had a close relationship with Mercy Housing.

In addition to the longtime ties, the nonprofit developer's latest project stood out from a mission standpoint because the development will serve a special-needs population in need of quality affordable housing.

Looking at certificated credits in general, both developers and investors can benefit, Sheth says.

For the investor, the fundamental difference is the allocated credit is treated as income so the value of it is automatically reduced by the amount of the federal tax you have to pay, which is why the pricing is lower. Certificated credits are considered personal property and can be used to reduce an investor's state tax liability but not have it impact the investor's ability to deduct state taxes from their federal taxable income, allowing for the pricing to be higher.

There's also another advantage. Under the program, CTCAC reserves certificated credits in the name of the nonprofit partner in the development. The nonprofit can then sell the credits to one or more investors, with the law allowing each initial investor to resell the credits one additional time.

"With the certificated credit being transferrable, it also increases the amount of people who can access it without having to have the expertise and the staff to close into an affordable housing deal," Sheth says. "… It's a win-win for everybody."

Construction on 180 West Beamer started in June. Twenty units will receive project-based Sec. 8 assistance from Yolo County Housing, the region's affordable housing and community development agency, which also provided a no-cost 99-year land lease to make the project happen.

Affordable Housing Finance

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Aug 22, 2017

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