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Disciplines
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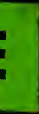

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AN EXAMINATION OF CORPORATE INVESTMENT IN TANDEM HISTORIC REHABILITATION TAX CREDIT AND LOW-INCOME HOUSING TAX CREDIT PROJECTS

Stacy Elizabeth Spies

A THESIS

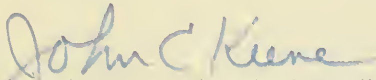
in

Historic Preservation

Presented to the Faculties of the University of Pennsylvania
in Partial Fulfillment of
the Requirements for the Degree of

MASTER OF SCIENCE

1994



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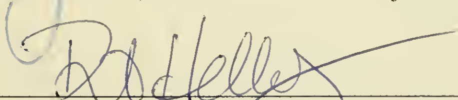
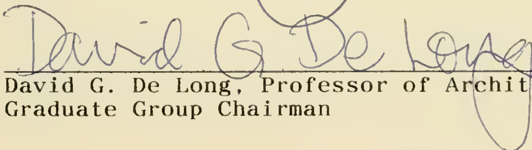


David Hollenberg, Lecturer, Historic Preservation, Reader



David G. De Long, Professor of Architecture
Graduate Group Chairman

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I would like to thank my thesis advisor, John Keene, for his enthusiasm. It was at his urging that I began research on this topic often avoided by preservation students and it is largely due to his encouragement that I followed through on this often dry, yet vitally important, topic.

I would also like to thank my reader, David Hollenberg, for his insightful observations and editorial skills.

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TABLE OF CONTENTS

CHAPTER 1: INTRODUCTION 1

CHAPTER 2: JUSTIFICATION AND USE OF TAX CREDITS IN HOUSING PRESERVATION AND NEIGHBORHOOD PRESERVATION 6

I. Tax Incentives Defined 6
II. Justification of Tax Incentives Toward Meeting the Social Goals of Historic Preservation and Affordable Housing 9
III. Role of Tax Incentives in Private Investment 15
  A. Impact of Recent Amendments to the Internal Revenue Code on the Use of Tax Credits 15

CHAPTER 3: THE HISTORIC REHABILITATION TAX CREDIT AND THE LOW-INCOME HOUSING TAX CREDIT: TECHNICAL REQUIREMENTS OF TANDEM USE 27

I. The Historic Rehabilitation Tax Credit 27
  A. Justification of the Historic Rehabilitation Tax Credit 27
  B. Method of Determining Eligibility and Amount of Credits 28
    1. Rates 28
    2. Definition of Qualified Status 29
      a. Historic Building 30
        i. Substantial Rehabilitation Requirement 30
        ii. Prior Use Requirement 30
      b. Historic District 31
      c. Non-Historic Building 31
        i. Substantial Rehabilitation Requirement (as above) 31
        ii. Prior Use Requirement (as above) 31
        iii. Wall Retention Requirement 31
    3. Certification Process 32
    4. Qualified Costs and Time Limitations 33
    5. Ownership and Compliance Requirements 34

II. The Low-Income Housing Tax Credit 35
A. Justification of Low-Income Housing Tax Credit 35
B. Method of Determining Eligibility and Amount of Credit 36
1. Credit Amounts 36
2. Definition of Qualified Status 37
A. Targeting Requirements 37
B. Eligible Basis 39
C. Rent Limits 40
D. Provision for Similar Treatment of Low-Income and Market-Rate Units 41
3. Tax Credit Allocation Process 42
4. Qualified Costs and Time Limitations 47
5. Ownership and Compliance Requirements 47

III. Use of the Credits in Tandem: Optimization of Rehabilitation Expenditures 48
A. Method of Tandem Use 49
B. Benefits and Drawbacks of Tandem Use 52
1. Benefits 54
2 . Drawbacks 58
C. Results of Tandem Use 59

CHAPTER 4: CORPORATE INVESTORS: THEIR ROLE IN TAX CREDIT PROJECTS AND HOW TO ENCOURAGE INCREASED INVESTMENT **64**

I. Nature of Corporate Taxation and Investment 64
A. Case Studies of Corporate Investment 68
1. National Equity Fund 68
2. Boston Capital 72
II. Attracting Corporate Investors 76
A. Why Corporate Investors in Particular? 76
B. How Do We Attract Corporate Investors? 77
1. Advantages to Corporate Investment in the HRTC and LIHTC 78
2. Disadvantages to Corporate Investment in the HRTC and the LIHTC 85
C. Encouraging Increased Corporate Investment 88

CHAPTER 5: CONCLUSION **91**

APPENDICES **96**

BIBLIOGRAPHY **115**

CHAPTER 1.

INTRODUCTION

The nation's current housing crisis, coupled with decreased funding at all government levels, has necessitated savvier funding strategies and increased recruitment of the private sector by those who support neighborhood preservation. A vacuum has been left by the Reagan and Bush Administrations which slashed public housing funds by 80 percent between 1980 and 1992,[1] making direct federal funding scarce. Further, the nature of privately financed housing has also changed; money for investment is less often found in the traditional commercial bank, and new funding sources are desperately needed to meet a growing need. In 1972, 40 percent of the assets to be lent were held by commercial banks; by 1992, that percentage had dropped to 25 percent. Similarly, savings and loans associations held 17 percent of the assets to be lent in 1972; by 1992, that percentage had dropped to less than 10 percent.[2]

In place of direct federal funding and lending by commercial banks, private investment, specifically corporate investment, has grown. Corporate investment in the rehabilitation of historic buildings for affordable housing

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1 Christina Del Valle, "Low-Income Housing: Is there a Better Way?" Business Week (June 22, 1992): 61.
2 Rich Ferlauto, "Innovative Financing for Preservation Projects" (Paper presented at the National Trust for Historic Preservation Conference, St. Louis, Missouri, 30 September 1993), no page.

through use of the Historic Rehabilitation Tax Credit (HRTC) and the Low-Income Housing Tax Credit (LIHTC) together (or "tandem" use) has become the funding solution for many projects. Due to amendments to the Internal Revenue Code of the last decade, individual private investors have been greatly limited and have not been able to sustain the level of investment enjoyed by tax credit projects a decade ago. A new investor pool is needed and corporations can be that pool.

Although corporate investment in the HRTC has only comprised between 10 percent and 17 percent of the total investor pool since 1986 (compared to individual investment between 39 percent and 61 percent),[3] corporate investment has shown a consistent increase over the same time period. (Figure 1.) This continues to occur, with a recent "boom" in corporate investment in Low-Income Housing Tax Credits occurring over the last 12 months.[4]

Advocates of neighborhood preservation must become aware of and understand this funding source in order to access these funds. The purpose of this study is to bring corporate investment activity to the attention of historic preserva-

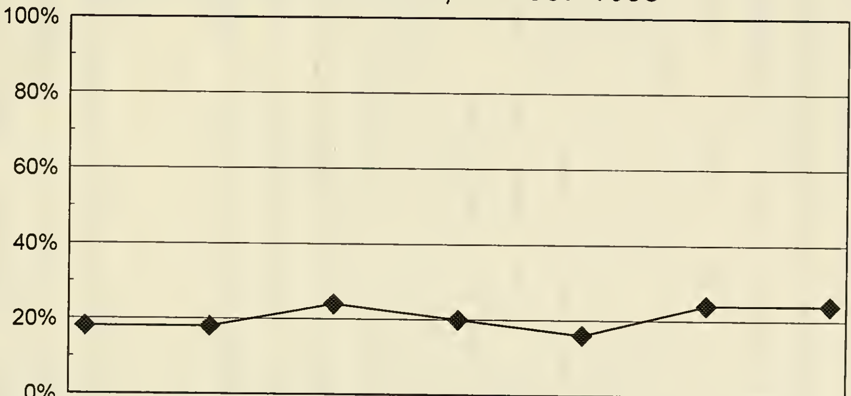
---

3 Susan Esherich, "Tax Incentives for Rehabilitation Fiscal Year 1993 Analysis" (National Park Service, U.S. Department of the Interior, Washington, D.C., 1993, Photocopy), iii.

4 Jeff Goldstein, Boston Capital, telephone interview with author, 7 March 1994.

FIGURE 1

HISTORIC REHABILITATION TAX CREDIT
PERCENTAGE OF CERTIFIED REHABILITATION PROJECTS
CORPORATELY OWNED, FY 1987-1993



Fiscal Year	1987	1988	1989	1990	1991	1992	1993
Corporation ◆	18%	18%	24%	20%	16%	24%	24%

National Park Service Tax Incentive Fiscal Year Reports,
FY 1987 - FY 1993 (Fiscal Year is October 1 to September 30)

Explanation of Statistics:
National Park Service statistics separate ownership types into four categories: Individual; Corporation; General Partnership; and Limited Partnership. Since partnerships can consist of either individuals or corporations, and organizations such as Boston Capital may involve both general and limited partnerships, I took the partnerships' percentages and divided them between individual and corporate owners in the same ratio as individual and corporate owners alone.

tion advocates who may not be familiar with the magnitude of investment dollars available for neighborhood preservation and may not be familiar with the mechanisms for gaining access to and encouraging such investment. Advocates for housing affordability and availability have raised concerns about anything that might stand in the way of providing adequate housing resources, and historic preservation has, at times, been seen as an obstacle to that goal. However, historic preservation and affordable housing advocates can and must work together to preserve communities. Preserving the existing building stock improves opportunities for preserving the communities that inhabit the buildings and for supporting revitalization by fostering pride and empowerment. Neighborhood preservation is possible if preservation and housing advocates work together to tap into the private investment money available today.

Used alone, both the HRTC and the LIHTC have successfully induced investment, but used in tandem, the two credits prove to be a highly profitable investment by increasing returns. Investors recognize this fact and in 1993, the National Park Service reported that 18 percent of HRTC projects used the LIHTC as part of the funding package. This percentage could increase through increased education. To better understand such investment, this thesis also

provides information on the technical requirements of tandem use of the HRTC and the LIHTC. The most important technical requirements are that the building be historic (in the regulatory sense) and that it be used as low-income rental housing.

Between 1986 and 1993, "the private sector, motivated by profit, has developed nearly 500,000 units of quality affordable housing for Americans of moderate income levels."[5] While all these projects may not have used the tax credits specifically, the lesson is clear: the private sector, once it is motivated by profit, can contribute to neighborhood preservation through economic investment. Such opportunities can only be enhanced, and their numbers increased, by broadening investors' and community advocates' understanding of tandem use of the HRTC and the LIHTC. This thesis will examine the nature of corporate investment and, most importantly, how and why these investors choose the HRTC and the LIHTC as the vehicles for their investment dollars. An understanding of the factors that lead corporations to tax credit investments will provide tools with which to educate future investors as well as to educate advocates of historic preservation and affordable housing.

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5 Boston Capital, "Boston Capital Corporate Tax Credit Fund II Investor Summary" (Boston Capital, Boston: Photocopy), 5.

CHAPTER 2.

JUSTIFICATION AND USE OF TAX CREDITS IN HOUSING PRESERVATION AND NEIGHBORHOOD PRESERVATION

I. Tax Incentives Defined

Taxation is a form of government intervention into market activities for the purpose of raising revenue for the government. Tax incentives, or expenditures, are revenue losses due to preferential treatment in the tax laws. Governments use tax incentives (generally credits, deductions, abatements) to encourage particular activities, such as charitable contributions, home ownership, historic preservation, or low-income housing and thereby avoid the appropriations process in Congress. For example, direct government interference with religious operations is eliminated if Congress does not need to give money directly to religious institutions. Instead, Congress can provide incentives for the private citizen to undertake these activities, achieving the same end of funding for the institutions.[1]

> Fiscal incentives are less controversial [than regulations] because citizens and business owners can choose whether they want to take advantage of a particular incentive. However, debate often centers around the desirability of allocating funds to promote "specific interests" or to subsidize uneconomic land uses.[2]

I General discussion of incentives following is as presented by Prof. John Keene, Lecture, September 20, 1993, CPLN 725, Univ. of Pa.
2 Joni L. Leithe, Thomas Muller, John E. Peterson and Susan Robinson. <u>The Economic Benefits of Preserving Community Character: A</u>

Tax credits are a type of tax incentive that creates a dollar for dollar reduction in one's tax bill, after adjusted gross income has been determined and after deductions have been taken. As a result, they are the most attractive and potentially lucrative tax incentive. They can be worth, depending on the relevant tax bracket, approximately 3 times as much as a tax deduction. The Historic Rehabilitation Tax Credit and the Low-Income Housing Tax Credit in particular are the subject of this thesis. There are a number of advantages and disadvantages to using credits as vehicles for social policy to achieve the goals of historic preservation and low-income housing.

One advantage to tax credit incentives for investors is lessened intrusion on private activity. Taxpayers choose for themselves whether or not to use the credits and are free to use the credits without concern for year-to-year fluctuations in the Federal appropriations process. Credits are also more stable than appropriations; once they are in place they operate somewhat "out of sight, out of mind", as opposed to yearly publicized appropriations battles.

Practical Methodology (Chicago: The Government Finance Officers Association, 1991), 9.

Tax credits can also amount to much larger amounts of money dedicated to a specific activity than would appropriations alone. For example, since the preservation tax incentives program began in June 1976 (effectively Fiscal Year 1977), historic rehabilitation tax credits have been a part of $16.2 billion in historic preservation activity. This amount represents approximately 24 times the amount that has been appropriated by Congress for the Historic Preservation Fund in the same time period.[3] At the peak of the historic tax credit use, the credits had become widely known by developers, accountants and lawyers, and were set into use by individual and corporate investors eager for tax savings. The 1986 Tax Reform Act affected such investment negatively, yet "because other tax benefits were also curtailed, credits are as attractive as ever in relative terms. They remain a powerful incentive for developers to [use when undertaking] future...projects."[4]

Disadvantages of using tax credits in general as vehicles for social policy include the view of incentives as "back-door" appropriations with no direct accountability for

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3 Susan Esherich, "Tax Incentives for Rehabilitation Fiscal Year 1993 Analysis" (National Park Service, U.S. Department of the Interior, Washington, D.C., 1993, Photocopy), 2. and Susan Esherich, "Tax Incentives for Rehabilitation Fiscal Year 1992 Analysis" (National Park Service, U.S. Department of the Interior, Washington, D.C., 1992, Photocopy), i.

4 Gaylon Greer, "Tax Credits: Still the Best Show in Town," Real Estate Review 18 (no. 2): 67.

activities. This same "out of sight, out of mind" rationale concerns some people that it is resultantly difficult to measure the effectiveness and degree of use of the incentives. Developers have stated that as many as 80 percent of historic rehabilitation tax incentive projects would not have been undertaken without the incentives.[5] It is in the developers' best interests to claim the credits are indispensable. If they state they are not using the credits, the credits could be taken away. Another, perceived disadvantage of using tax credits is that they generate projects that would have had little financial viability on their own and may add to the problem of vacant buildings when the projects eventually fail.

II. Justification of Tax Incentives Toward Meeting the Social Goals of Historic Preservation and Affordable Housing

Tax credit incentives to rehabilitate historic buildings and to increase the stock of affordable housing foster private investment in preservation and low-income housing. "Ultimately, incentives are the answer to the property owner's question, What's in it for me?"[6] While some might

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5 Esherich, "Tax Incentives for Rehabilitation Fiscal Year 1992 Analysis," 2.
The percentages of developers stating that projects would not have been undertaken without the credit are as follows: FY 1987, 80%; FY 1988, 75%; FY 1989, 80%; FY 1990, 78%; FY 1991, 74%; FY 1992, 78%; FY 1993, 67%. (Source: NPS statistics FY 1987-FY 1993.)
6 Marya Morris, Innovative Tools for Historic Preservation (Washington, DC: American Planning Association, 1992), 1.

hope that private citizens would take the initiative to act solely for the common good, it often takes a financial incentive to make such activity happen. The tax credits were created out of the understanding that historic rehabilitation and low-income housing projects do not always generate a profit, and therefore need incentives to encourage investors.

Tax incentives provide a contract of sorts between the property owner and the public. As compensation for supporting the public welfare by rehabilitating a cultural resource and making affordable housing available, the government increases the attraction of such activities for the investor. The incentives compensate for the regulatory and cost burdens which owners of rehabilitated historic buildings may face and to compensate for the decreased rents that low-income building owners will receive. For benefiting the public with affordable housing and with the preservation of cultural resources, the owner receives some return.

There are many arguments in favor of using preservation and rehabilitation as tools in neighborhood preservation and in the creation of affordable housing for the common good. First, historic preservation and rehabilitation retains and reuses materials; it is true recycling. "[It] is a

conserver, rather than an over-consumer, of scarce public resources,"[7] it is practical, "it is a means of recovering the worth of past investments,"[8] and it follows common sense.

> Historic preservation is a rational and effective economic response to overconsumption. To make a new brick today to build a building on a site where there is already a building standing steals from two generations. It steals from the generation that built the brick... by throwing away their asset before its work is done, and it steals from a future generation by using increasingly scarce natural resources today that should have been saved for tomorrow.[9]

It seems irresponsible to build new structures if existing structures are usable and the infrastructure is underused. Existing building stock -- whether historic or not -- represents a massive investment in materials, labor and time,[10] and reuse can spare local and regional governments the cost of duplicating utilities and services.

Second, preservation and housing also work together to provide employment. Rehabilitation is more labor intensive than new construction by as much as 25 percent. One study

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7 Donovan Rypkema, "The Economics of Rehabilitation" No. 53 of the National Trust for Historic Preservation Information Series (Washington, DC: The National Trust for Historic Preservation, 1991), 21.
8 Bruce K. Chapman, "The Growing Public Stake in Urban Conservation" in National Trust for Historic Preservation, eds. Economic Benefits of Preserving Old Buildings (Washington, DC: The Preservation Press, 1975), 9-13.
9 Rypkema, "Economics," 21.
10 Chapman, "The Growing Public Stake," 9-13.

shows that new construction yields 70 jobs per $1 million spent, while rehabilitation yields 109.[11] This is especially valuable because high concentrations of the unemployed tend to live in areas with many historic structures, usually older city cores. Further, if community groups such as community development corporations (CDCs) do the construction work, community residents benefit three times over by helping them to earn a living, by creating or perpetuating job skills, and by creating affordable housing for themselves.

Third, rehabilitation and preservation address the problems of abandoned and underused housing by reusing existing resources in areas where people are underhoused. Ironically, while the country struggles to adequately house its citizens, much of the existing housing stock sits empty and deteriorating, the result of real estate market forces that have made it more profitable to build new than to reuse what already exists. Tax credits allow reuse to be a viable option.

The current availability of affordable housing in our urban cores is not meeting demand even though urban populations are dropping in many areas. It would be rational to believe

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11 Lauren C. Archibald et al, "Historic Preservation in the 1990s" (Seevak Family Foundation Student Research Competition, 3 April 1992), 4.

that there would therefore be a sufficient supply of empty rental units; however, this is not the case. Arson and abandonment persist and renter incomes continue to drop, widening the gap between market rents and truly affordable rents. Nationally,

> 483,000 units were demolished each year from 1985 to 1989. Of these losses, 197,000 were rental units. In addition to outright demolition, inventory losses result from conversion, upgrading, and temporary removal of units. Each of these actions reduces the supply of low-cost housing and adds to the pressure on rents at the low end of the market.[12]

Philadelphia particularly feels this pressure; only 15 percent of Pennsylvania's housing stock is in Philadelphia, yet one of every four overcrowded units and two of every three boarded-up units in the State are located there.[13] The National Institute of Building Sciences reports that nationwide, "about 100,000 units of privately owned housing affordable to households with incomes below 50 percent of median are dropping out every year. And this is the housing picture only in the private sector."[14] The Philadelphia

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12 Joint Center for Housing Studies of Harvard University, The State of the Nation's Housing 1993 (Cambridge, Mass.: Joint Center for Housing Studies of Harvard University, 1993), 14.
13 Pennsylvania Housing Finance Agency. Pennsylvania Housing: An Assessment of Special Housing Needs in the Commonwealth (Harrisburg, Pa.: Pennsylvania Housing Finance Agency, 1990), 10.
14 National Institute of Building Sciences, Meeting America's Housing Needs Through Rehabilitation of Existing Housing and Vacant Buildings (Washington, D.C.: National Institute of Building Sciences, 1987), 2.

Housing Authority has a public housing waiting list of 13,000 people.[15]

"It is estimated that households in Pennsylvania with unmet housing needs could exceed one million by the year 2000,"[16] one-twelfth of the state's residents. These people will most likely be renters.

> The drop in renter household income [nationwide] reflects the recession-induced rise in the incidence of poverty. In 1991, a total of 12.9 households had poverty-level incomes, up from 11.4 million in 1989 and above the previous record of 12.5 million in 1983. The increase was largely among renter households, whose numbers in poverty reached an all-time high of 8.6 million -- a 16 percent increase since 1989 and nearly double the number recorded in 1974.[17]

Even though homeowners have benefitted from the recent decline in interest rates, this benefit has not trickled down to renters, whose monthly costs remain high. "[L]ow and moderate income households are two and one-half times more likely than middle- and upper-income households to depend on the rental market for their shelter."[18] Further, "[l]ow income renters were most likely to be in unaffordable housing; 71 percent of low income renters paid in excess of

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15 "PHA rate of vacancy still rising," Philadelphia Inquirer, 31 March 1994.
16 Pennsylvania Housing Finance Agency. Pennsylvania Housing, vii.
17 Joint Center for Housing Studies, The State of the Nation's Housing 1993, 13.
18 Pennsylvania Housing Finance Agency. Pennsylvania Housing, viii.

30 percent, and 60 percent paid greater than 35 percent of their incomes for rent."[19]

> Measured in inflation-adjusted terms, median renter household income fell 8.6 percent from $17,300 in 1989 to $15,820 in 1992. With lagging income growth and near-record rent levels [they peaked in 1987], rent burdens moved up again in 1992. Nationwide, the gross rent burden ... rose to 30.8 percent -- a 25-year record.[20]

III. Role of Tax Incentives in Private Investment

Tax credits are a solid incentive to attract private investment and encourage preservation at its most common denominator -- as real estate. Rehabilitation and low-income projects must compete favorably with new construction on some combination of criteria such as degree of risk, interest rates, after-tax income, strength of the local real estate market, and age, condition, and location of the property in order to attract private capital.[21] The Historic Rehabilitation Tax Credit and the Low Income Housing Tax Credit make the playing field more level for low-income and older structures and make such projects more attractive to real estate investors.

A. Impact of Recent Amendments to the Internal Revenue Code on the Use of Tax Credits

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19 Pennsylvania Housing Finance Agency. Pennsylvania Housing, 3.
20 Joint Center for Housing Studies, The State of the Nation's Housing 1993, 13.
21 Rypkema, "Economics," 2.

In order to demonstrate the impact of tax incentives on investment in historic rehabilitation and affordable housing projects, the development of incentives provided in the Internal Revenue Code must be presented. The discussion below will present developments in tax law relevant to the HRTC and the LIHTC.

1. Pre-1986 Provisions of the Internal Revenue Code Relating to Rehabilitation of Historic Structures

a. Tax Reform Act of 1976

The Tax Reform Act of 1976 provided: 1) either a 5-year amortization of qualified expenditures in the rehabilitation of a certified historic structure <u>or</u> accelerated depreciation of a substantially rehabilitated historic structure; 2) costs of demolishing a certified historic structure could not be claimed as deductions; and 3) buildings constructed on the site of a demolished or substantially altered certified historic structure were restricted to straight-line depreciation.[22]

b. Revenue Act of 1978

The Revenue Act of 1978 provided "a 10% credit for qualified expenditures incurred in the rehabilitation of a building

[22] National Park Service, <u>Preservation Tax Incentives for Historic Buildings</u> (Washington, D.C.: U.S. Department of the Interior, 1992), 22.

that had been in use for a period of 20 years before the commencement of rehabilitation."[23]

c. Economic Recovery Tax Act of 1981 (ERTA)

The Economic Recovery Tax Act of 1981 created attractive, and more substantial, incentives for historic rehabilitation. ERTA provided a 25 percent credit for rehabilitation costs of certified historic buildings (residential or non-residential). Two credits for *non-residential* buildings only (and, therefore of less relevance to this study) were also created: a 20 percent credit for rehabilitation costs of non-residential buildings more than 40 years old; a 15 percent credit for the rehabilitation costs of non-residential buildings 30-39 years old, with the additional provision of 15-year straight-line depreciation. The standard depreciation period was 19 years. All credit amounts could be taken in the first year, investors at all income levels could benefit, and the credit could offset any type of income.

At least partially a result of favorable tax incentives between 1981 and 1986, use of the HRTC soared, with an upsurge in both approved projects and investment funds. In Fiscal Year 1981 there were 1,375 approved HRTC projects and by Fiscal Year 1984 that number had risen to 3,214 projects.

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[23] National Park Service, Preservation Tax Incentives for Historic Buildings, 22.

The number of projects remained high in 1985 and 1986, but that number dropped to 1,092 in 1988 at least partially as a result of the Tax Reform Act of 1986.[24] (Figure 2.)

2. Pre-1986 Provisions of the Internal Revenue Code Relating to Low-Income Housing

Before the creation of the Low-Income Housing Tax Credit in 1986, there were three major federal incentives for private sector investment in low-income housing: 1) the rapid amortization provision, which allowed rehabilitation expenditures for low-income housing to be amortized on a straight-line basis over a 5 year period; 2) the 15 year accelerated depreciation allowance; and, 3) treatment of construction period interest and taxes as expenses. In return for the above, building owners were required to rent to a minimum number of low-income individuals, but there were no rental income limitations and building owners were free to charge low-income individuals any rental amount they wished.[25]

3. The Tax Reform Act of 1986 (TRA)

The Tax Reform Act of 1986 dramatically altered the tax incentives for historic rehabilitation and low-income housing, adversely and beneficially, respectively. TRA 1986

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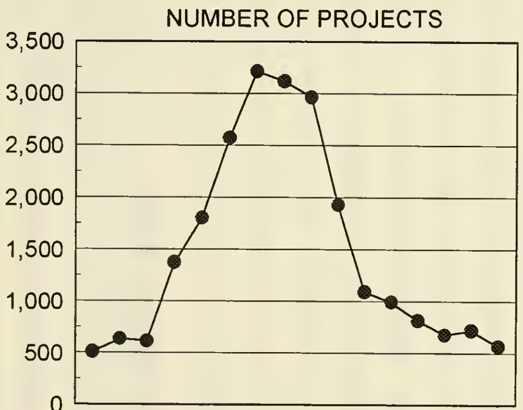
24 Donovan Rypkema and Ian D. Spatz. "Rehab Takes a Fall." Historic Preservation (December 1990): 1.

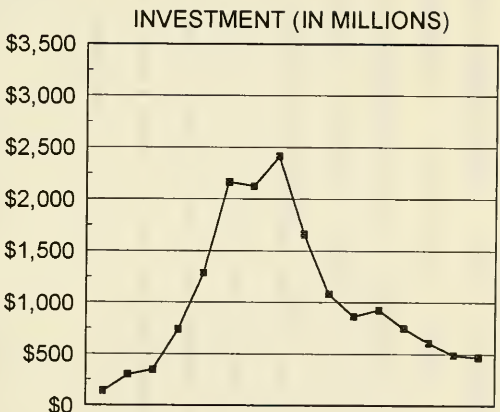
25 Michael J. Novogradac and Eric J. Fortenbach, Low-Income Housing Tax Credit Handbook (New York: Clark Boardman Company, Ltd., 1990), 1--4.

FIGURE 2

HISTORIC REHABILITATION TAX CREDIT
APPROVED REHABILITATION PROJECTS AND INVESTMENT, FY 1977-1993



Fiscal Year	77-78	79	80	81	82	83	84	85	86	87	88	89	90	91	92	93
Approved Projects	512	635	614	1,375	1,802	2,572	3,214	3,117	2,964	1,931	1,092	994	814	678	719	566



Fiscal Year	77-78	79	80	81	82	83	84	85	86	87	88	89	90	91	92	93
Estimated Investment (in Millions)	140	300	346	738	1,284	2,164	2,123	2,415	1,661	1,083	865	927	750	608	491	468

National Park Service Tax Incentive Fiscal Year Reports, FY 1977 - FY 1993
(Fiscal Year is October 1 to September 30)

created the Low-Income Housing Tax Credit and greatly increased the opportunity for private investment in affordable housing. The credit sought to increase low-income tenant occupancy and to correct weaknesses in the prior provisions, which did not provide sufficient incentives to build low-income rental units. For example, prior to TRA, an entire project was eligible for the subsidy once the minimum threshold of low-income units was met and there were no incentives to set aside more low-income units beyond that threshold.

Prior to 1986, the three major low-income housing incentives discussed above operated in an uncoordinated manner and failed to guarantee that affordable housing would be provided to the most needy low-income individuals;[26] people with incomes as high as 80 percent of area median income were eligible.[27] A major shortcoming was that "beyond a minimum threshold requirement of low-income units that were required to be served, the degree of subsidy was not directly linked to the number of units serving low-income individuals."[28] This meant that implementation was weak and

---

26 Charles E. Daye, et al. Housing and Community Development, Cases and Materials (Durham, North Carolina: Carolina Academic Press, 1989), 164-5 is an excerpted version of Joint Committee on Taxation, General Explanation of the Tax Reform Act of 1986, H.R. 3838, 99th Cong., Public Law 99-514, 1987: 152-154.
27 Daye, et al. Housing and Community Development, Cases and Materials: 152-154.
28 Daye, et al. Housing and Community Development, Cases and Materials: 152-154.

it was the developers, not the tenants, who benefitted from the incentives.

The Tax Reform Act of 1986 "exerted a considerable adverse impact on real estate as an investment"[29] by removing most of the tax incentives that had made real estate investment relatively more attractive than many other forms of investment. It did so by creating passive loss limitations, lengthening the depreciation period, diminishing the amount of credit available, diminishing the eligible investor pool, and diminishing the amount of credit allowed to be taken per investor per year.

The TRA introduced limitations on the deductibility of passive losses affecting both the HRTC and the LIHTC. These passive loss limitations have had a particularly detrimental effect on the attractiveness of the HRTC to *individual* investors; however, *corporate* investors are <u>not</u> subject to the passive loss limitations. No longer could individuals use any amount of the credit against taxes owed on any type of income. Before 1986, most real estate transactions were structured so that there was a loss for tax purposes. In order to restrict the abuse of HRTCs as tax shelters through the generation of excessive losses, TRA 1986 created the

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29 Donovan Rypkema, "The Recession: Good News in Bad Times." <u>Historic Preservation Forum</u> 5, no. 3 (May/June 1991): 16.

passive loss limitation rules that "preclude claiming most real estate losses against income not derived from real estate."[30]

> [W]hile most tax rates were reduced [as a result of TRA], the capital gains tax dramatically increased... to 28 percent. Preferential tax treatment for the sale of a capital asset no longer existed. Individual tax rates were reduced significantly... Lower individual rates meant that those [tax] losses were of less relative value, thus rendering the real estate itself less valuable on an after-tax basis.[31]

One of the reasons offered for major tax changes in 1986 was that tax incentives were "too" attractive and significant government revenues were being lost.

The TRA separated individual taxpayers' income into three "baskets": 1) active income -- wages and salary; 2) portfolio -- stocks and dividends; 3) passive income -- including but not limited to real estate investments and rental income received by real estate non-professionals. Losses incurred in any one of these baskets could no longer offset gains in any other basket. Thus, real estate investment losses could no longer be offset against earned income, interest income, dividends or the like. This made the HRTC and the LIHTC much less attractive to the high-income public that had made up a large portion of these investors.

30 National Real Estate Investor, "Special Tax Issue," National Real Estate Investor 28 (No. 14): 6.
31 Rypkema, "The Recession: Good News in Bad Times," 16.

As a result of TRA, individuals could deduct up to $25,000 of their real estate losses against non-passive income if they actively participated in real estate activity and had an income under $100,000. If their income exceeded $100,000, the $25,000 limit was decreased by $.50 for each $1.00 of income over $100,000. This allowance was phased-out completely if their incomes exceeded $150,000.

The HRTC and the LIHTC

> received special treatment for purposes of this allowance. The special treatment is twofold: First, the adjusted gross income phaseout range is increased from $100,000 - $150,000 to $200,000 to $250,000. Second, the active participation rule does not apply. Investors in [LIHTC or HRTC] projects [could] claim tax credits without regard to their degree of participation."[32]

(Also see OBRA 1989 below.)

Moreover, only $7,000 of the full amount of the credit can be used in any one year; previously, under ERTA, all credit amounts could be taken in the first year under ERTA. This limit is determined by multiplying the individual tax rate by the credit cap ($25,000 credit x 28 percent tax bracket = $7,000 credit per year). To make it possible to use the entire credit amount earned, tax credits may be carried back 3 taxable years and carried forward for 15 years.

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[32] Novogradac and Fortenbach, Low-Income Housing Tax Credit Handbook, 3--115.

Another option exists for those investors with more credit available than may be used in that year: the amount of the credit can be sold via a syndicator or directly to another investor.[33] (This option will be discussed in more detail in Chapter 4.)

As individuals earning more than $250,000 per year are not allowed to use any part of the HRTC or LIHTC, the TRA thus effectively eliminated typical pre-1986 use of the HRTC by individuals. The number of approved projects dropped by more than two thirds between 1986 and 1990 and continued to drop through Fiscal Year 1993.[34] (Appendix 2.) Although investors earning over $250,000 had only constituted 13 percent of HRTC investors, these individuals had contributed more than 43 percent of the total dollars invested in HRTC projects.[35] The corporate exemption from passive activity loss limitations should provide opportunities for significant investment dollars subject to fewer limitations. This study examines methods of attracting corporate investors to fill this void.

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33 Michael J. Novogradac and Eric J. Fortenbach, "Tax credits for low-income housing: LIHC program can subsidize rental building costs: Industry leaders advise entrepreneurs to participate." National Real Estate Investor 32, no. 3 (March 1990): 87.
34 Rypkema and Spatz. "Rehab Takes a Fall," 1.
35 Donovan Rypkema and Ian Spatz, "The Tax Reform Act's Passive Activity Rules," Urban Land (October 1987): 9.

The depreciation period of 19 years which had existed under ERTA was lengthened to 27.5 years. This lengthening "meant that the annual depreciation deduction was reduced, thereby increasing the amount of real estate income that was subject to federal income tax,"[36] and thereby creating another deterrent to real estate investment.

4. Omnibus Budget Reconciliation Act of 1989 (OBRA 1989)

The Omnibus Budget Reconciliation Act of 1989 repealed the $250,000 income ceiling restriction for investors in low income housing tax credits that had been present as a result of the 1986 TRA. Beginning with properties put in service after 1989, investors in low income housing projects could use tax credits in an amount equivalent to $25,000 in losses against ordinary income without regard to their total income.[37] The $200,000 - $250,000 adjusted gross income phaseout was eliminated for LIHTC investors; the phaseout and income ceiling remained intact for HRTC investors. Thus, tandem credit investors may benefit from an eliminated phaseout where they would be subject to the phaseout if they were investing in an HRTC project alone.

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36 Rypkema, "The Recession: Good News in Bad Times," 16.

37 Pennsylvania Housing Finance Agency, "Federal Low Income Rental Housing Tax Credit Program Guide," (Pennsylvania Housing Finance Agency, Harrisburg, Pa., 1993, photocopy), 1.

OBRA 1989 introduced the 30-year extended use agreement as a requirement of the states' allocation process, forcing compliance to LIHTC requirements over a 30-year period. Thus, projects constructed for low-income housing which utilized the LIHTC had to remain in that use for a minimum of 30 years. (See Chapter 3.)

5. Omnibus Budget Reconciliation Act of 1993 (OBRA 1993)

After seven years of temporary status, and after expiring on June 30, 1992, passage of OBRA 1993 reinstated the Low-Income Housing Tax Credit retroactively to July 1, 1992 and made it permanent.

OBRA 1993 also provided moderate relief from passive activity limitations for individuals (not corporations) who *materially participate* in real estate activity. Individuals may offset passive losses against all of their income beginning in tax years after 1993. These real estate professionals must work in real estate for more than half of their overall employment time, with a minimum of 750 hours per year. Such "real property trade or business" activities include development, construction, and rental activities. They must also have at least a 5 percent ownership in their employer's firm if they are an employee.

CHAPTER 3.

THE HISTORIC REHABILITATION TAX CREDIT AND THE LOW-INCOME HOUSING TAX CREDIT: TECHNICAL REQUIREMENTS OF TANDEM USE

I. The Historic Rehabilitation Tax Credit (HRTC)

A. Justification of Historic Rehabilitation Tax Credit

A primary economic assumption about the HRTC is that the public receives long-term value through historic preservation in both economic and non-economic terms, that might not or could not be provided solely by the property developer in the short-run.[1] This justification is in addition to those presented above with regard to incentives in general. "Over the life of the program, since Fiscal Year 1977 [until 1992], the use of Federal tax incentives to encourage private investment in historic rehabilitation has been one of the most effective Federal programs to promote both urban and rural revitalization."[2] The credit is specifically targeted at and limited to income-producing historic properties.

> The historic rehabilitation tax credits, unlike many many other public interest programs, have done exactly what they were meant to do -- encourage the investment of private capital in an area broadly recognized as being in the public good. The fiscal efficiency and programmatic

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1 Donovan Rypkema, "The Economics of Rehabilitation" No. 53 of the National Trust for Historic Preservation Information Series (Washington, DC: The National Trust for Historic Preservation, 1991), 5.

2 Susan Esherich, "Tax Incentives for Rehabilitation Fiscal Year 1992 Analysis" (Washington, D.C., U.S. Department of the Interior, 1992, Photocopy), 1.

> effectiveness of the federal tax credits for historic preservation can be favorably compared with any other federal program.[3]

The 65 percent decline in rehabilitation activity

> after the passage of the 1986 Tax Reform Act is firsthand evidence that the economic viability of historic preservation and a usable tax credit are directly interrelated.[4]

B. Method of Determining Eligibility and Amount of Credit

1. Rates

The Historic Rehabilitation Tax Credit available as a result of TRA 1986 consists of a 20 percent credit of qualified rehabilitation costs incurred with a certified historic building or a 10 percent credit of qualified rehabilitation costs incurred with a non-historic non-residential building.

There is no cap on the amount of historic rehabilitation credit available in a given year, as there is with the LIHTC nor is credit available for building acquisition costs as there is with the LIHTC. Lastly, the presence of additional federal subsidy does not affect the amount of the HRTC, as it does in the calculation of the LIHTC.

A historic building is defined as a building which is either listed on, or eligible for listing on, the National Register of Historic Places, or is a building in a National Register,

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3 Rypkema, "Economics," 21.
4 Ibid.

state or local historic district and is certified as being of significance to the district. Properties accepted for listing on the National Register are not usually less than 50 years old, but properties built more recently may be eligible for listing due to historic significance. A non-historic building is defined as a building placed in service before 1936 that is without demonstrable historic significance. There is no such cut-off year for historic buildings. (Appendix 1.)

2. Definition of Qualified Status

Requirements exist for both historic and non-historic buildings. First, all buildings must be used for trade or business or held for rental. To be eligible for the 20 percent credit, historic buildings may be used for residential or non-residential use; for the 10 percent credit qualifying non-historic buildings may only be used for non-residential use. These limitations mean that in order to link together the LIHTC and the HRTC, the property must be a historic building. Such restrictions limit the type and range of buildings eligible to use both credits.

Second, specific requirements relate to the treatment of the building types to qualify for the credit.

a. Historic Building

To be certified as eligible for the 20 percent tax credit, the rehabilitation of a historic building must satisfy the following two requirements:

i. Substantial Rehabilitation Requirement

Rehabilitation costs must be greater than the adjusted basis of the building or be at least $5,000. For purposes of the credit, the adjusted basis is defined as the acquisition cost of the property minus the cost of the land, minus depreciation previously taken. Acquisition costs and the costs to expand the size of the rehabilitated building are not included in the substantial rehabilitation calculation for the HRTC, but may be eligible -- subject to restrictions -- when the HRTC is used in tandem with the LIHTC on a single project.

ii. Prior Use Requirement

The building must have been used as a building prior to rehabilitation. Despite the obvious-sounding nature of this requirement, it means that the credit may not be used, for example, to convert a boat into a museum or a railway car into a restaurant.

b. Historic District

If a building is contributes to a National Register District, the project can only qualify for the 20 percent credit or none at all. If a building located in a historic district is not itself a certified historic structure, it may still qualify for the 10 percent credit if the rehabilitation project is certified by the State Historic Preservation Officer or if the State Historic Preservation Officer officially certifies that the building is not of significance to the district.

c. Non-Historic Building

To be certified as eligible for the 10 percent tax credit, the rehabilitation of a non-historic building must satisfy the following three requirements:

i. Substantial Rehabilitation Requirement (as above)

ii. Prior Use Requirement (as above)

iii. Wall Retention Requirement

A non-historic building must satisfy the substantial rehabilitation requirement and the prior use requirement as must historic buildings, but a non-historic carries and additional requirement: the wall retention requirement. This requirement has both external and internal requirements.

- At least 75 percent of the original external walls must be retained as either external or internal walls.
- At least 50 percent of those original external walls must continue to be used as external walls. In other words, any additions that may be added to the original building during rehabilitation must not cover more than 25 percent of the original external walls, thus rendering them internal.
- At least 75 percent of the internal structural framework must remain in place.

Rehabilitation of a certified historic building does not mandate the wall retention requirement, but the rehabilitation must follow the overall Secretary of the Interior's Standards for Rehabilitation. In a historic building, existing external walls may not be the historic walls or the walls may have lost their integrity due to deterioration. Historic buildings, however, "generally should satisfy the external wall retention test."[5]

3. Certification Process

Historic rehabilitation tax credits for certified historic buildings are available for any project that the Secretary of the Interior designates as a qualified rehabilitation of a certified historic structure. Non-historic buildings do

5 National Park Service, Preservation Tax Incentives for Historic Buildings (Washington, D.C.: Department of the Interior, 1992),7.

not need this type of certification. Requests for certification of historic status are made to the State Historic Preservation Officer (SHPO) who reviews and forwards the application to the regional National Park Service (NPS) office. The NPS then determines whether the rehabilitation project conforms to the Secretary of the Interior's Guidelines for Rehabilitation. (Appendix 2.) Even though the state historic preservation office reviews projects prior to forwarding the National Park Service, the National Park Service is entrusted with administering compliance with these standards. This process differs from that of LIHTC administration which creates partnerships between the federal and state agencies; all applications are made to the state agency, not the federal agency.

Plans for historic rehabilitation should be approved before construction begins. A rehabilitation project must maintain the historic character and integrity of the property and must continue to be a contributing property within the historic district.

4. Qualified Costs and Time Limitations

The project must be completed within 24 months, during which time all qualified expenses must be incurred. If this creates an unviable time constraint, the project may be organized into phases, if it is approved beforehand and if

all phases are completed within 60 months. To receive permission to use the phased 60-month period, the taxpayer must provide a written set of architectural plans and specifications for all phases of rehabilitation and demonstrate that it can be reasonably expected that the project will be completed within this time.

Both hard and soft costs qualify for inclusion in the eligible basis. Costs that qualify include: rehabilitation costs; architectural and engineering fees; legal and professional fees; developer's fees; construction interest and taxes; and general and administrative costs. Costs that do not qualify include: acquisition costs (which is a factor when this credit is used with the low-income housing credit); cost of enlarging the property, sales and marketing costs; realtor's fees.

5. Ownership and Compliance Requirements

The tax credit must be taken for the tax year in which the building is placed in service. The credit is subject to recapture at a proportional rate if the property is sold within five years of being placed in service or if the rehabilitation subsequently performed does not conform to the Secretary of the Interior's Standards for Rehabilitation.

II. The Low-Income Housing Tax Credit

A. Justification of Low-Income Housing Tax Credit

The Low-Income Housing Tax Credit creates an incentive to owners of low-income housing projects for rehabilitation of structures as well as for new construction and building acquisition.[6] The credit is justified on the basis that it compensates owners and developers for the resultant reduced rental income. Further justification is that it is for the common good to house citizens who are homeless, underhoused, or paying too much for housing. One account reports that the LIHTC has assisted in the construction or renovation of more than 400,000 housing units from 1986 through 1992.[7]

According to the Local Initiatives Support Corporation (LISC), the low-income housing tax credit has now become the main tool for producing new affordable housing. In both 1991 and 1992, the LIHTC was responsible for the production of 94 percent of such housing.[8]

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6 As explained to the author in a telephone conversation on 9 June 1994 with Phillip M. Friday of the Pa. Housing Finance Agency, 1987 was the first year the LIHTC was truly in effect. The IRS took a while to get the regulations and rules out after the TRA in 1986; the rules were not published until October 1987. Further, it took a while for the credit to become familiar to users.

7 Christina Del Valle, "Low-Income Housing: Is there a Better Way?" Business Week (June 22, 1992): 61.

8 "National Equity Fund Commits To Five-Year, $I.5 Billion Effort," Housing and Development Reporter: Current Developments 11 October 1993: 326.

B. Method of Determining Eligibility and Amount of Credit

1. Credit Amounts

Three activities -- acquisition, rehabilitation, and new construction -- trigger two tiers of tax credits which vary depending on whether the project has additional federal subsidies, as follows:.

Project	No Other Federal Subsidy	Additional Federal Subsidy
Rehabilitation	**70% (approx. 9% per year)**	**30% (approx. 4% per year)**
New Construction	70% (approx. 9% per year)	30% (approx. 4% per year)
Purchase of Existing Property	30% (approx. 4% per year)	30% (approx. 4% per year)

While the HRTC is claimed all at once in a single tax year, the LIHTC is claimed annually over a ten-year period, with the set credit percentages over that same 10-year period. The credits will equal a present value of 70 percent of the basis of new construction which is not federally subsidized. For rehabilitation, the credits will equal a present value of 70 percent of the rehabilitation basis of an existing building which is not federally subsidized. The credits will equal a present value of 30 percent of the basis of a building which is federally subsidized (either new

construction or rehabilitated) and a value of 30 percent of building acquisition costs.[9]

The Internal Revenue Service (IRS) assigns monthly percentages which will yield the 70 percent and 30 percent present values; these percentages are determined by the month the project was put into service. For example, an investor in a building put in service in April 1994 would receive annually an 8.48 percent (averaged as 9 percent) credit which will provide the 70 percent present value credit. The investor would receive annually a 3.63 percent (averaged as 4 percent) credit which will provide the 30 percent present value credit. (Appendix 3.) If the applicable yearly rates are high enough, the total dollar amounts of the credits over the ten-year period can exceed the dollar value of the building's qualified basis.[10]

2. Definition of Qualified Status

A. Targeting Requirements

Types of residential rental property that qualify for the credit include apartment houses, single family dwellings, townhouses, and rowhouses. Cooperatives and tenant-stockholder arrangements do not qualify. Further, the rent

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9 The 70% and 30% present value rates replace the respective 9% and 4% rates used in the first full year of the credit's life (1987).

10 Research Institute of America, Special Incentive Credits (New York City: Research Institute of America, 1993): 35,476.

cannot include any "supportive services" (and any incumbent fees for such services) such as would be found in nursing homes, intermediate care facilities for the mentally or physically handicapped, or transitional programs for the homeless which include programs such as physical or mental health or programs that help them to find permanent housing. A qualified project must be used for non-transient rental use (typically a 6-month minimum lease) and must be available for rental to the general public. An exception is provided for single room occupancy (SRO) housing, which permits units to be rented on a monthly basis, provided the units are not used to house the homeless on a transitional basis.[11]

There are minimum federally-established set-aside rules to ensure adequate provision for sufficient numbers of low-income units in mixed-income unit projects. One of three options must be chosen by the applicant at the time of allocation: 1) at least 20 percent of a project's units must be rented to families earning 50 percent or less of area median gross income ("the 20/50 rule"); 2) at least 40 percent of a project's units must be rented to individuals earning 60 percent or less of area median gross income ("the 40/60 rule") or; 3) at least 15 percent of a project's

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11 Pennsylvania Housing Finance Agency, "Federal Low-Income Rental Housing Tax Credit Program Guide," (Pennsylvania Housing Finance Agency, Harrisburg, Pa., 1993, photocopy), 1.

units must be rented to individuals earning 40 percent or less than area median gross income (15/40). In this last option, referred to as "deep rent skewing", the remaining non-low-income units must be rented for at least 200 percent of the rents being charged to the low-income tenants for a comparable unit. For projects in New York City, the federal targeting requirements are altered to reflect extremely high housing costs in that city: at least 25 percent of a project's units must be rented to individuals earning 60 percent or less than area median gross income ("the 25/60 rule").[12]

B. Eligible Basis

Because tandem use of the LIHTC and the HRTC is the focus of this paper, discussion of the LIHTC stresses its requirements and rates for rehabilitation over those for new construction. The eligible basis for the LIHTC has a number of federal requirements which must be met before the credit may be applied. The qualified rehabilitation expenditures must be the greater of two tests: at least $3,000 must be spent per unit OR the total costs must be more than 10 percent of the adjusted basis of the project. Tax credits for acquisition costs of a building are not permitted unless rehabilitation costs are equal to the greater of $3,000 per

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12 Internal Revenue Service Form 8609 "Low-Income Housing Credit Allocation Certification," and Research Institute of America, eds., RIA Tax Coordinator: Special Incentive Credits. Vol. 17A. (New York: Research Institute of America, 1993), Paragraph L-15804, Paragraph L-15805.

unit or 10 percent of the adjusted basis. Thus, rehabilitation is given preferential treatment by making it a prerequisite of the acquisition credit.

Calculation of the credit is as follows:

A)	**Eligible Basis** = new construction, rehabilitation or acquisition costs
B)	**Applicable Fraction** = whichever is smaller: percentage of units designated as low-income to total units in building OR the percentage of low-income rentable floor area to non-low-income rentable floor area
C)	**Qualified Basis** = A x B
D)	**Applicable Percentage** = 70 percent or 30 percent
E)	**Amount of tax credit** = (A x B) x D

C. Rent Limits

Rents, including utilities, may not constitute more than 30 percent of tenants' incomes (gross rent limitations are based on units size rather than household size, with 1.5 persons estimated per bedroom). Low-income tenants can pay no more than 30 percent of the income limit for the unit, i.e., 30 percent of 40 percent, 50 percent, or 60 percent of area median gross income. (The 1993 area gross median income for Philadelphia was $46,600, using a family of four as the standard of comparison.) (Appendix 6.) The non-low-income units are not subject to this limitation. An owner has 12 months after a building is placed in service to meet these targeting requirements.

D. Provision for Similar Treatment of Low-Income and Market-Rate Units

The amount of the credit is based on the total amount of rehabilitation work done to the building and the percentage of the building occupied by eligible low income tenants.[13] The justification is that such an incentive will promote inclusion of additional low-income units in a property since each additional unit will increase the investor's tax benefits[14] by increasing the applicable fraction in the calculation of the credit. A larger applicable fraction will create higher returns.

Not only is there is no advantage in doing rehabilitation only in those units that will be occupied by eligible low income households, there is a disincentive. In order to ensure continued targeting compliance, there are penalties if the units set aside for low-income families are of lesser quality than those for higher incomes. For any market-rate units in the building that are of a higher quality than the designated low-income units, the costs attributable to the higher quality will be subtracted from the eligible basis when calculating the amount of the credit.

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13 Joseph Guggenheim, Tax Credits for Low-Income Housing (Washington, DC: Simon Publications: 1987): 7.

14 Arthur C. Nelson and Michael A. Stegman, "Tax Reform and Planners", Journal of the American Planning Association (Summer 1987, No. 3): 300.

> If the 'average quality standard' of the low income units is lower than that for the non-low income units, then the entire 'eligible basis...of the non-low income units with the higher quality is deducted in computing the amount of the credits. The low income percentage remains the same but is applied against a lower basis.[15]

Units are of comparable quality if the construction costs are comparable.[16]

In contrast to the extensive rehabilitation standards required for certification of an HRTC project, LIHTC projects have no such design review standards. This contrast becomes apparent when the credits are used in tandem: developers familiar with minimal design restrictions in LIHTC projects may be uncomfortable with -- or unwilling to adhere to -- the extensive HRTC standards. This may discourage some potential developers from undertaking tandem projects.

3. Tax Credit Allocation Process

To further complicate the LIHTC, federal law limits the total dollar amount of low-income housing credits available per state. Eligible projects must apply for and obtain an allocation from the state housing agency no later than the year the project is placed in service. The state housing credit ceiling for any state for any calendar year is equal

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15 Guggenheim, Tax Credits for Low-Income Housing: 9.
16 Research Institute of America, eds., RIA Tax Coordinator: Special Incentive Credits. Vol. 17A., 35,495.

to the sum of four "pools" of credits. Each state is first permitted to allocate credits at the rate of $1.25 per state resident per calendar year, based on the most recent census figures. Second, any unallocated credits from the previous calendar year may be allocated. Third, any unused, and returned, credits from the prior calendar year may be allocated. Finally, if the state used all of the credits available to it in the previous calendar year, the state may be eligible to allocate credits from a national pool of credits made up of unused credits nationwide. "The national pool is allocated among qualifying states based upon relative population."[17]

For example, in 1989, "State X" receives an allocation at the per capita rate. If "State X" uses all of its 1989 credits, and uses all of its unused and returned credits, the state then gets to tap into the national pool of unused credits. If "State X" does not use all of its 1989 allocation, it may carry the remaining state allocation amount over into 1990. If any 1989 credits remain unused (either unallocated or returned) by 1991, the unused amount is transferred to the national pool.[18] Pennsylvania allocates its tax credits in three cycles per year,

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17 Michael J. Novogradac and Eric J. Fortenbach, Low-Income Housing Tax Credit Handbook (New York: Clark Boardman Company, Ltd., 1990), 3A--17.

18 Cherie Iappini, Origination Department, Boston Capital, telephone conversation with author, 9 June 1994.

allocating 40 percent, 40 percent and 20 percent of the annual credits each time. (Appendix 4.) Philadelphia receives 23.6 percent of Pennsylvania's total annual allocation.[19]

Unused allocations are common, as funding deals fall through for the developer, LIHTC requirements may not be met, or, the developer simply changes his or her mind.[20] The national pool was created to recoup "lost" allocations such as these. The state allocation carryover amounts and the national pool challenge developers to use the credits for which they apply, and the carryover amounts make allocations available to those who are in the greatest need for additional allocations (projects that are nearing the completion stage, for example).

Once a developer applies to the state housing agency, the LIHTC project application is evaluated for viability and costs, and then ranked by that agency according to priorities set forth by the agency. The state housing agency is directed by federal regulations to create an allocation plan which sets forth priorities appropriate to

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19 Pennsylvania Housing Finance Agency, "Federal Low Income Rental Housing Tax Credit Program Guide: Exhibit C," (Pennsylvania Housing Finance Agency, Harrisburg, Pa., 1993, photocopy), 3.
20 Phillip M. Friday, Director of Information Resources, Pennsylvania Housing Finance Agency. Telephone Conversation with Author. 9 June 1994.

that state's local conditions and sets forth selection criteria. The LIHTC process involves the state housing agencies as partners in evaluating and processing credit applications, wherease the HRTC process is directed and processed at the federal level. Such LIHTC priorities include provisions for units with more bedrooms and designs for special groups such as the elderly or disabled. Priority is given to projects according to costs and completeness of planning, which can include factors such as the extent of funding committed to the project, syndicator and developer costs as percentages of total project cost, and projects that have set-asides well above the minimum, among other factors. Selection criteria must include project location, housing needs characteristics, project characteristics, sponsor characteristics, and public housing waiting lists. (Appendix 4.) The application is ranked according to fulfillment of criteria and adherence with priorities and the project is allocated tax credits accordingly.

The National Council of State Housing Agencies (NCSHA) estimated at mid-year that $477.4 million in low-income housing tax credits were expected to be available nationwide in 1993. This number included $318.851 million in per capita credits, $96.175 million in 1992 carryover, $32.714 million in returned credits, and an estimated $29.7 million

in the national pool to be shared by seven states.[21] NCSHA end-of-year statistics for 1993 show that these estimates were low with $546.4 million in credits (per capita + returned + carryover + national pool) available and $424.7 distributed by year's end. (Appendix 5.) Pennsylvania was allocated over $15 million in per capita tax credits in 1994 (approximately 12 million people multiplied by $1.25 per capita).[22]

The program's hiatus in 1992 due to the expiration of the credit (prior to the reinstatement of the credit with OBRA 1993) has caused large portions of states' allocations to go unused; this will lead to an increased national pool in 1994, which will diminish, presumably, by 1996, when the newly-permanent credit catches up with demand. Now is the time to take on a low-income housing project, if only because the chances of receiving available allocation dollars are better than in prior years.

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21 "$477.4 Million in Authority Expected to Be Available in 1993," Housing and Development Reporter: Current Developments, 7 June 1993: 47 and "Half of States Likely to Allocate All Available Credits This Year," Housing and Development Reporter: Current Developments, 6 December 1993: 458

22 Friday, Telephone Conversation with Author. 9 June 1994.

4. Qualified Costs and Time Limitations

Costs included in the adjusted basis are amounts chargeable to a capital account. Rehabilitation costs eligible for the tax credit include "hard" construction costs as well as "soft" costs, such as engineering and architectural fees, general contractor fees, building permits, developer's fees, and construction period interest. Acquisition costs eligible for the tax credit include, but are not limited to: structures, title and recording, and legal fees associated with acquiring the building.[23] The eligible basis used to calculate the credit is equal to the adjusted basis, less the cost of land for the acquisition credit, less the HRTC, less any grants received. As with the HRTC, there is a 24 month period during which the construction must be done and expenditures in the adjusted basis made.

5. Ownership and Compliance Requirements

The property must comply with the above requirements for 15 years from the first taxable year for the credit. In addition to this first 15-year period, a second 15-year "extended use period" must be followed. The second period is federally mandated with OBRA 1989 to be a condition of the state credit allocation process. This commitment is an agreement between the taxpayer and the housing credit agency

23 Pennsylvania Housing Finance Agency, "Federal Low Income Rental Housing Tax Credit Program Guide," (Pennsylvania Housing Finance Agency, Harrisburg, Pa., 1993, photocopy), 8.

in which the property owner commits to comply with requirements for an additional 15 years over the 15 year compliance period and commits to maintain the applicable fraction. This agreement is recorded as a restrictive covenant and is binding on all successive owners should the property be sold.

The property may be sold within the compliance period, subject to 2 restrictions: 1) if it is reasonably expected that the building will continue to be operated as a qualified low-income building for the remaining compliance period; 2) if the new owner furnishes the IRS with a bond secured by a surety from the Treasury Department. The credit is subject to recapture of a portion of all credits plus interest. Should these, or any other, requirements not be met, the credit is subject to recapture.

III. Use of the Credits in Tandem: Optimization of Rehabilitation Expenditures

Reusing existing housing in our neighborhoods is an economical method of providing affordable housing and preserving (or creating) neighborhood stability. "There are practical reasons for rehabilitation and there is a de facto

acceptance of it since older housing is often where poor people live."[24]

The belief that housing and preservation can work together is gaining speed. Currently, two-thirds of the low-income housing project allocation applications passing through the Pennsylvania Housing Finance Agency already involve substantial rehabilitation, even though rehabilitation is not set out specifically by the state as a preferred selection criterion.[25] 18 percent of HRTC projects in Fiscal Year 1993 also used the LIHTC,[26] and 10 percent of Pennsylvania LIHTC projects also used the HRTC.[27] Linking together the financial incentives which assist in this process is the key ingredient to success.

A. Method of Tandem Use

Using the two credits in tandem requires that the resultant property be rental housing and certified as historic. In order to fulfill HRTC requirements the rehabilitation project must:

- be a historic building (because a non-historic building may not be residential, but its adaptive

24 Friday, Telephone Conversation with Author. 9 June 1994.
25 Ibid.
26 Susan Esherich, "Tax Incentives for Rehabilitation Fiscal Year 1993 Analysis." (Washington, D.C.: U.S. Department of the Interior, 1993), 29.
27 Vera Nelson, Tax Credit Coordinator, Pennsylvania Housing Finance Agency. Telephone Conversation with Author. 27 July 1994.

reuse is acceptable, e.g. conversion from school to housing);

- be income-producing (rental);
- cost the greater of $5,000 or an amount equal to the adjusted basis of the building;
- be owned by a single owner for at least 5 years.

In order to fulfill LIHTC requirements the project must:

- be for residential rental use (and therefore, must be historic because only historic buildings may be for residential use.)
- cost the greater of at least $3,000 per low-income unit or more than 10 percent of the adjusted basis;
- comply for 30 years (federal compliance period plus extended low-income housing commitment)
- be owned for 15 years.

Therefore, the resultant requirements are:

- A rental residential property on the National Register of Historic Places (or eligible for listing) or contributing to a historic district.
- Must spend at least $3,000 per unit *and* over $5,000 on rehabilitation costs or more than the adjusted basis of the building.

- Project must also be owned for at least 15 years by owners and must comply for 30.

The two credits are linked together are as follows:

1) Apply the 20 percent HRTC credit toward the rehabilitation costs.
2) Apply the 70 percent LIHTC toward the remaining 80 percent of eligible rehabilitation costs, and the 30 percent LIHTC toward acquisition costs.

For the purposes of this example I will use the approximate yearly percentages of 9 percent and 4 percent (as introduced on page 37). Hence, the resultant totals will, too, be approximate.

No Other Federal Subsidy		
Costs $500,000 building	$1,000,000	rehabilitation
HRTC	- 200,000	20% X rehab.
LIHTC	- 72,000	9% X 80% rehab.
LIHTC - 20,000		4% X building acq.
Total Tax Credit = $292,000 on $1.5 million spent (i.e. about 19.5% on total rehabilitation and acquisition.)		

Additional Federal Subsidy (included in Costs)		
Costs $500,000 building	$1,000,000	rehabilitation
HRTC	- 200,000	20% X rehab.
LIHTC	- 32,000	4% X 80% rehab.
LIHTC - 20,000		4% X building acq.
Total Tax Credit	**= $252,000 on $1.5 million spent (i.e. about 16.8% on total rehabilitation and acquisition.)**	

B. Benefits and Drawbacks of Tandem Use

Both historic rehabilitation and low-income housing tax credit projects are increasingly dependent upon numerous funding sources above and beyond the tax credits themselves. Yet, given the right combination of circumstances -- relatively modest construction or acquisition costs, relatively healthy local income levels, some form of subsidy, developers knowledgeable of and comfortable with complex funding combinations, and access to appropriate investors - tandem tax credit projects can be a lucrative investment vehicle. Such a consideration is dependent upon a number of elements being in the right place at the right time and should not be viewed as a reliable set of conditions.

The subsidy mix does get complicated quickly, which may deter use of the credit by developers uninterested or unwilling to participate in such complicated projects.

Additional funding vehicles such as HOME Section 515 financing, UDAG, HODAG, CDBGs, and below market rate loans create a complex mix, and though they are vital to the success of most projects, they significantly complicate the process. It is not unusual to find fifteen or more funding sources in a low-income housing project.[28] HUD is currently drafting subsidy layering guidelines for projects involving the low-income housing tax credit. The agency hopes this will ease confusion, but the draft guidelines have been criticized to date for being overly-restrictive and for creating yet another layer in the allocation and credit receipt process.[29]

The reason for increased subsidies is to make the units as affordable as possible. "Owners have little incentive to peg rents to the lower level of 50 percent of gross area median income. The tax credit amount is rarely adequate to achieve the lower 50 percent rent level without substantial additional assistance."[30] Thus, without encouragement, rents will gravitate toward the 60 percent area gross median income level, eliminating many prospective tenants' chances of finding affordable housing.

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28 Friday, Telephone Conversation with Author. 9 June 1994.

29 "Half of States Likely to Allocate All Available Credits This Year," Housing and Development Reporter: Current Developments, 6 December 1993: 458 and "Subsidy Layering Draft Increases Allowances for Syndication Costs," Housing and Development Reporter: Current Developments 20 December 1993: 490.

30 Guggenheim, Tax Credits for Low-Income Housing: 87.

1. Benefits

a. Increased Credit

Investors receive an increased credit on the same basis. If rehabilitation work is being undertaken to receive the HRTC, compliance with LIHTC requirements will allow for the remaining unusable 80 percent of the rehabilitation costs to be applied to a LIHTC credit, without any further expenditure (the remaining 20 percent having been taken with the HRTC). Additionally, since receipt of the acquisition credit is dependent upon and determined by rehabilitation costs, historic rehabilitation will permit additional credit receipt through the acquisition credit.

b. Tandem Use is Efficient Method of Construction

Rehabilitation can save time and money over new construction, and can therefore keep costs down, which leads to more affordable housing. It has been estimated that renovation can cut costs by as much as one-third over new construction.[31]

Rypkema estimates that,

> if new construction requires incurring the costs of razing an existing building, the cost savings from rehabilitation should range from 3 percent to 16 percent. Furthermore, [for] whatever can be reused

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31 Nora Richter Greer, "Affordable Housing Crisis Sparks Evolutionary Solutions," Preservation Forum 3, No. 3 (Fall 1989): 18.

> -- mechanical, plumbing or electrical systems, windows, roof repair instead of replacement -- the cost savings will increase significantly.[32]

and,

> Rehabilitation can often reduce the construction time up to 18 percent; even more if there are significant regulatory hurdles to overcome. Additionally, it is often possible in rehabilitation to generate rents while the work is going on -- not generally an option with new construction.[33]

c. Tandem Use Preserves Neighborhoods

Low-income households in revitalizing neighborhoods may be displaced for a number of reasons, some because their residence is sold or repaired, others due to neighborhood-wide changes. Renters in properties that are not sold or rehabilitated may be displaced if their rent is raised as a result of reinvestment in other neighborhood properties.[34] (Since tandem use of the credits requires that the properties be income-producing, tax credit properties may not be owner-occupied. Therefore, tandem credit use may not foster the goal of community ownership.) Public perception that displacement will occur is still strong at the neighborhood level. On the other hand, some neighborhoods have experienced such outmigration that remaining residents welcome any new investment. In any case, given current

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32 Rypkema, "Economics," 7.

33 Ibid.

34 Frank F. DeGiovanni, "An Examination of Selected Consequences of Revitalization in Six U.S. Cities," Urban Studies 21 (No. 3): 254.

economic conditions, displacement may not be as large a concern right now as it has been in the past.[35]

Accountants concerned with the property specifically, warn their clients that neighborhood health is vital to resale and that "careful selection of the best possible locations for low-income housing projects is instrumental to property appreciation. Another important factor is conscientious property management."[36] Since investors will want to be able to sell off the property at the end of the compliance period so that they may receive additional benefits, they will want to ensure that the property was well-maintained and neighborhood quality maintained or improved. Although motivated by property disposal profits, their concerns are in alignment with those of community residents: both groups want stability and growth.

d. Increased Spending Per Unit

Credits encourage increased spending per unit, even if it is only a small amount, as that amount may be just enough to make the project eligible for the tandem credits when it

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35 Elizabeth B. Waters, mediator, "Historic Preservation and Affordable Housing: Breaking Down the Barriers," Report from roundtable discussion sponsored by National Trust for Historic Preservation and the National Park Service, 7 July 1993, 3.
36 Earl C. Brewer, Jr., "Corporate Investments in Low Income Housing -- High Return, Low Risk, Fast Payback," Journal of Taxation (January 1989): 2 Photocopy reproduced in Boston Capital Corporate Tax Credit Fund II Investment Summary.

otherwise might not have been. Consider as an example the hypothetical scenario of an historic 4-unit residential building to be used for low-income housing:

If $2,750 is spent per unit - which is too little to qualify for the LIHTC - and $10,000 is spent on acquisition costs of the building, the total amount spent after applying the HRTC's 20 percent credit is $18,800.

4 units x $2,750 =	$11,000	rehabilitation costs
	- 2,200	20% HRTC
	8,800	
	+10,000	acquisition
	$18,800	Total spent

Yet, if only $250 more is spent per unit, $3,000, the project will be eligible for the HRTC <u>and</u> the LIHTC. If $10,000 is again spent on acquisition of the building, the total amount spent after applying the credits is <u>less</u>: $18,336.

4 units x $3,000 =	$12,000	rehabilitation costs
	- 2,400	20% HRTC
	9,600	
	- 864	9% LIHTC x 80% of rehabilitation costs
	8,736	
	+10,000	acquisition
	18,736	
	- 400	4% x $10,000 acquisition
	$18,336	Total

Thus, by spending just $250 more per unit, the taxpayer will actually save $464 on the overall project cost. $250 in

amenities to an apartment can make a significant difference in the quality of life for low-income tenants.

2. Drawbacks

a. Need For Responsible Tenants

Tenants must treat the building well so that it retains its historic integrity; if the historic integrity is compromised, the HRTC is subject to recapture. Potential investors may find the responsibility of maintaining historic integrity above and beyond standard maintenance requirements too burdensome. Even though tenants are typically screened for responsibility and the owner typically covered by a standard lease agreement, in an instance such as this, the worst result of irresponsible tenants is not the loss of property value do to damage, but the additional risk of credit recapture due to damage to the property.

b. Timing

Using these two credits in tandem is obviously a "niche" investment and is largely dependent upon a number of feasible options all coming together at the same time. It is also dependent upon developers' familiarity with the two credit processes and with a desire to undertake rehabilitation projects of this nature.

c. Rising Tenant Incomes

While project risk is lowered by having a low income tenant base, which usually results in a near zero vacancy rate,[37] caution is necessary as difficulties may arise if family income levels rise too much in the neighborhood and tenants' incomes rise above the gross median area income. If income levels rise too high, the family would become ineligible for the low-income units. However, the Internal Revenue Code takes such fluctuations into account: household income can increase up to 40 percent above current eligibility levels and the unit may remain qualified as a low-income unit. Although this consideration may provide a buffer in certain circumstances, it is a risk that needs to be acknowledged when seeking credit use.

C. Results of Tandem Use

To evaluate the success of tandem use of credits without considering the current overall economic downturn would be unfair. There has been a downturn in market-rate housing and new construction just as there has been a downturn in low income housing and historic rehabilitation. Further, because overall tax benefits have been curtailed since 1986, the relative importance of the credits has risen.

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37 Lauren C. Archibald, Gregory F. Esterman, Jared Z. Mintz and Christopher R. Tilley. "Historic Preservation in the 1990s" (Seevak Family Foundation Student Research Competition, University of Pennsylvania, 1992), 17.

In 1992, the number of approved HRTC projects increased -- by a tiny 6 percent -- over the previous year for the first time since 1984. That increase was not repeated in 1993. 719 projects involving $491 million in rehabilitation expenses were approved by the National Park Service in 1992,[38] but the number of rehabilitation projects approved in 1993 was only 17 percent of the number approved in 1984, before the 1986 tax changes. (Figure 2.) Improvement has appeared -- and disappeared just as quickly -- and there is still a long climb ahead to return to prior levels.

Nevertheless, in 1993, 3,259 units of housing -- 40 percent of all historic rehabilitation projects approved that year -- were created in historic buildings, including about 1,546 low and moderate income housing units. These 3,259 units constitute a 41 percent increase in total housing units created over those created in 1991. These low and moderate income units form 47 percent of the total housing created using the historic credits in 1993. This percentage is a decrease since Fiscal Year 1992, which had the highest ratio of low and moderate units to market rate units produced under the program in a given year since the program began, with 1,762 low/moderate units to 2,013 units created.

38 Escherich, "Tax Incentives for Rehabilitation Fiscal Year 1992 Analysis," 1-3.

Between 1977 and 1993, over 130,000 housing units have been rehabilitated, of which nearly 25,000 have been low and moderate income units.[39] (Figure 3.)

Interestingly, analysis of the low/moderate units as a part of total investment in the HRTC shows that the fewest low/moderate units were created in the "boom" years of the HRTC program.[40] (Figure 4.) For example, in 1984 (pre-LIHTC) 3,214 projects were approved, but only 142 low/moderate income units were created out of those approvals. Since the creation of the LIHTC in 1986 (which took effect late in 1987), the number of approved HRTC projects has fallen, while the number of low/moderate units has grown fairly steadily. There may be a number of reasons for this, including the familiarity that investors have gained with the LIHTC and end of the real estate "boom" that had caused an increase in high-rent rehabilitation work. Faced with a glut of market-rate historic apartments, developers are turning to lower-income units because there is sufficient demand and incentive to do so.

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39 Esherich, "Tax Incentives for Rehabilitation Fiscal Year 1993 Analysis," 2.

40 These statistics were retrieved from submitted National Park Service Historic Preservation Certification Applications, Part 2 -- Description of Rehabilitation Work. The form asks if any units are low/moderate income, but does not ask whether the LIHTC was specifically used.

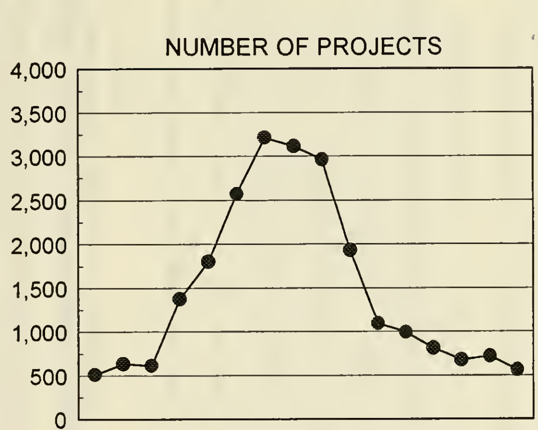
Figure 3.

Certified Historic Rehabilitation Projects Involving Low- and Moderate-Income Housing FY 1977-FY 1993			
	# Units Rehabilitated	# Units Created	# Low/Moderate Units Created
FY 1977-FY 1978	3,876	3,086	1,197
FY 1979	4,807	3,828	1,485
FY 1980	4,648	3,701	1,435
FY 1981	6,332	4,093	3,073
FY 1982	6,285	5,131	2,635
FY 1983	12,689	6,661	3,792
FY 1984	16,002	4,933	142
FY 1985	16,618	5,395	868
FY 1986	12,260	7,264	640
FY 1987	11,306	4,216	1,241
FY 1988	7,206	2,815	592
FY 1989	7,577	3,739	2,034
FY 1990	6,098	2,317	1,993
FY 1991	4,081	1,730	1,288
FY 1992	5,523	2,013	1,762
FY 1993	5,027	3,259	1,546
Totals	130,335	64,181	25,723

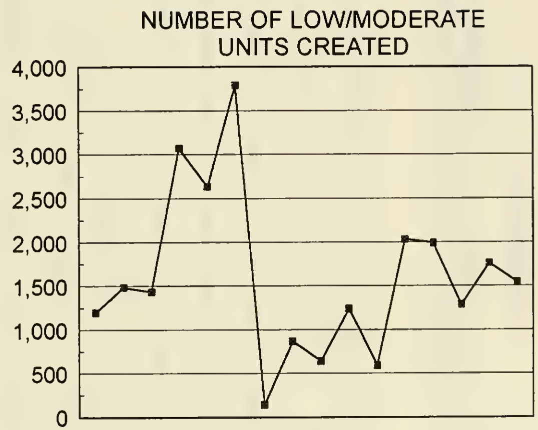
National Park Service Tax Incentive Fiscal Year Reports, FY 1987-FY 1993 (Fiscal year is October 1 - September 30)

FIGURE 4

HISTORIC REHABILITATION TAX CREDIT APPROVED REHABILITATION PROJECTS AND LOW/MODERATE HOUSING UNITS CREATED, FY 1977-1993



Fiscal Year	77-78	79	80	81	82	83	84	85	86	87	88	89	90	91	92	93
Approved Projects ●	512	635	814	1,375	1,802	2,572	3,214	3,117	2,964	1,931	1,082	994	814	678	719	566



Fiscal Year	77-78	79	80	81	82	83	84	85	86	87	88	89	90	91	92	93
Low/Moderate Units Created ■	1,197	1,485	1,435	3,073	2,835	3,792	142	888	640	1 241	582	2,034	1,983	1,288	1,762	1,546

National Park Service Tax Incentive Fiscal Year Reports, FY 1977 - FY 1993
(Fiscal Year is October 1 to September 30)

CHAPTER 4.

CORPORATE INVESTORS: THEIR ROLE IN TAX CREDIT PROJECTS AND HOW TO ENCOURAGE INCREASED INVESTMENT

I. NATURE OF CORPORATE TAXATION AND INVESTMENT

There are four types of corporations, all of which are subject to specific regulations and limitations. Widely-held corporations are the subject of this thesis, but the basic types should be defined in order to understand their differences. *"S" corporations* have 35 or fewer shareholders and are not taxed at the corporate level. Rather, "the corporate income, loss, and credits pass through to the shareholders and are taxed at the individual shareholder level."[1,2] Shareholders are then subject to passive loss limitations. *Personal service corporations* perform personal services by employee-owners, such as legal, accounting, medical and other consulting services. This type of corporation is subject to passive loss limitations and can only apply credits against passive income, much like individual investors. *Closely-held "C" corporations* have 5 or fewer shareholders who own 50 percent or more "of the corporate stock at any time during the last half of the

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1 Michael J. Novogradac and Eric J. Fortenbach, Low-Income Housing Tax Credit Handbook (New York: Clark Boardman Company, Ltd., 1990), 2--15, 2--16.

2 S corporations appear similar to limited partnerships but are subject to other specific regulations. The differences between the two are spelled out in Commerce Clearing House, Federal Tax Guide Reports Vol. 1A (Chicago: Commerce Clearing House, 1994), 3297.

taxable year. Closely-held C corporations are subject to a liberalized passive activity limitation rule, under which passive credits can offset tax attributable to portfolio income such as interest and dividends. *Widely-held corporations* are all other of corporate structures. They are not subject to passive loss rules, and, as such, "are ideal investors in low-income housing tax credit projects."[3] It is this last type of corporate investors to which this thesis refers. As used herein, unless noted otherwise, "corporation" refers to "widely-held corporation."

One of the less attractive characteristics of a corporation is that the corporation as well as its shareholders are taxed on income, and in this regard it is different from a partnership.

> From a tax standpoint, the main difference between a partnership and a corporation is that the latter is a taxable entity separate and distinct from its owners and shareholders. This is not true in the case of a partnership; a partnership does not pay a tax, but merely reports its income... A corporation is at a distinct disadvantage in that its earnings are ordinarily taxed twice -- once to the corporation when earned and again to the stockholders when received in the form of dividends.[4]

Because by entering into a partnership -- a "pass-thru entity"-- the investment is only taxed once (at the individual level), corporations may opt to invest in limited

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3 Novogradac and Fortenbach, Low-Income Housing Tax Credit Handbook, 2--15.

4 Commerce Clearing House, Federal Tax Guide Reports Vol. 1A, 1994: 3302.

partnerships to avoid corporate taxation regulations. Thus, to escape double-taxing, when investing in the Historic Rehabilitation Tax Credit and the Low-Income Housing Tax Credit, corporations most often join up with syndicators, who channel their money into limited partnerships.

Occasionally, a sizable corporation such as Chevron will take on tax credit projects on its own. Chevron has its own developers and sets up its own LIHTC projects. Chevron has a large real estate development division which builds market-rate condominiums and rental units,[5] and is therefore already familiar with the construction process.[6] Chevron's comfort with and knowledge of this area has helped them to become one of the largest single investors, corporate or otherwise, in LIHTC projects in the nation.[7]

Although syndicators may retain a tarnished reputation due to their perceived role in some of the more questionable real estate dealings of the 1980s and the "boom" years of the HRTC, they do create vehicles through which tax credits become accessible and therefore more desirable to corporations. One criticism has been that syndicators' fees

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5 Chevron Annual Report, 1992

6 To the best of my knowledge, Chevron undertakes new construction LIHTC projects and does not undertake rehabilitation projects, and, for this reason is of limited use as a typical example.

7 Jeff Goldstein, Vice President of Real Estate/Asset Management, Boston Capital. Telephone Conversation with Author. 7 March 1994.

divert large sums of money away from the rehabilitation/housing projects themselves. Writing about the LIHTC, William Giese noted that in a typical Boston Capital Tax Credit Series, "of the $35 million raised from investors, the syndicators take a huge, $9.5 million chunk off the top for expenses and their profit.[27 percent] Up-front fees can reach 18 percent."[8] The rest goes for the housing projects, along with three times as much in borrowed money, which is the main point of cooperation with syndicators: syndicators' money is solid funding which can be used to leverage much more funding, and is therefore highly desirable for the successful funding of a potential project.

Syndicators will typically offer developers returns of 80 cents on the dollar for HRTCs; LIHTCs can get between 43 and 50 cents on the dollar.[9] The difference in the going rate is that the HRTC brings more equity to a project and promises a return in the first year out; the LIHTC will take ten years for the investor to get his or her money back. "Up-front" cash is always preferable with cash flow considerations. "Time is money in real estate. The longer

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8 William Giese, "A real estate tax shelter the IRS can't touch," Kiplinger's Personal Finance Magazine 47 (March 1993): 63.
9 Tim Barry, St. Louis Equity Fund, "Innovative Financing for Preservation Projects" (Paper presented at the National Trust for Historic Preservation Conference, St. Louis, Missouri, 30 September 1993).

an investor has to wait to use up that tax credit, the less valuable it becomes."[10]

A typical low-income housing limited partnership is structured as follows:[11]

> The investors contribute capital to the upper-tier partnership (Investment Partnership) as limited partners; the Investment Partnership, in turn invests as limited partners in one or more lower-tier partnerships (Operating Partnerships) which own and operate the low-income housing properties. Each Operating Partnership has a local general partner who usually develops and manages the property and provides certain completion and operating guarantees. The general partner of the Investment Partnership or an affiliate frequently serves as either a special limited partner or co-general partner in each Operating Partnership to exercise certain decision-making rights on behalf of the Investment Partnership. (Appendix 7.)

This process will be elaborated upon in the Boston Capital case study below.

A. Case Studies of Corporate Investment

1. National Equity Fund

The Local Initiatives Support Corporation (LISC) was founded in 1979 by the Ford Foundation and six other corporations as a community development support organization which funds and brokers projects, and provides technical services to

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10 Rypkema, "Economics," 14.

11 Much of this discussion of limited partnership structure is adapted from John C. McCarthy, "Corporate Investment in Low-Income Housing Partnerships: Accounting Cloud With a Silver Lining," Real Estate Finance (Spring 1990). Reproduced in Boston Capital Corporate Tax Fund II Investment Summary.

community affordable housing projects. Working with over 875 nonprofit community development corporations (CDCs) in 30 cities, LISC sees itself as a "social investment banker," looking ahead to the future of communities.[12]

CDCs are based on the principle of people taking responsibility for their neighborhoods and working to revitalize the community themselves. The development of affordable rental housing in these neighborhoods by CDCs is a significant part of revitalization. "With LISC's help, CDCs have built or rehabilitated 42,000 decent, affordable homes and gained recognition as a driving force in community renewal."[13]

LISC created the National Equity Fund (NEF) limited partnership in 1987. The NEF intends to attract Fortune 500 corporate investors for the purpose of amassing equity to leverage funding for construction from other sources. By investing only in projects developed by non-profit CDCs, the employment, the work and the financing remains at the local level.

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12 Local Initiatives Support Corporation, "About the Local Initiatives Support Corporation," (Local Initiatives Support Corporation, Chicago, 1993, photocopy), 1.
13 National Equity Fund, 1992 Annual Report (Chicago: National Equity Fund, 1992), i.

Without corporate "start-up" money, community groups would most likely not be able to get the funding on their own. "With NEF's equity in place, local financing institutions, be they banks, lending consortia or philanthropies, work with city and state government agencies to complete the [financing] puzzle."[14] Further, NEF equity investments reduce overall financing needs, reducing overall costs and allowing lower rents to cover expenses. Corporate investors receive their return, estimated at between 15 percent and 18 percent, through use of the Low-Income Housing Tax Credit. (Appendix 8.)

The NEF is made up of three funds: NEF that finances projects nationwide; the New York Equity Fund (NYEF), in collaboration with the Enterprise Foundation, which invests in projects in New York City; and the California Equity Fund (CEF), which operates in California. Since 1987, NEF has raised $620 million from 108 corporations to create more than 14,000 units of affordable housing in more than 300 projects (developed by 193 CDCs) in 62 cities. (Appendix 9.)

$14.25 million was raised in NEF's first year. In 1992, 60 corporations, the most it had had in any one year, invested a total of $223 million. This money was invested in 93

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14 National Equity Fund, 1992 Annual Report, 3.

projects developed by CDCs in 37 cities. The Brantwood apartments developed by James Brown in the Parkside neighborhood of Philadelphia received $1.8 million in 1992 from NEF, which contributed to the $3.2 million in funding needed. Since 1989, NEF has provided nearly $32 million in equity -- which drew another $45 million from outside investors -- for 414 affordable housing units throughout the city of Philadelphia. Philadelphia area investors include PNC Bank, First Fidelity Bank and Mellon Bank.

In 1992, 4,500 units were created by NEF nationwide out of the $223 million, distinguishing NEF as "the largest, single user of Low-Income Housing Tax Credits in the country"[15] In September 1993, NEF announced their largest investment drive yet to raise $1.5 billion over the next 5 years nationwide. These funds will help produce more than 35,000 affordable housing units.[16] Philadelphia would receive $100 million of that amount, which could leverage another $100 million from other sources.

LISC/NEF only works with community developers with whom a long-term relationship has been nurtured. NEF's staff oversees construction budgets, secures tax credit

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15 National Equity Fund, 1992 Annual Report, 2.
16 "National Equity Fund Commits to Five-Year, $1.5 Billion Effort," Housing and Development Reporter: Current Developments, 11 October 1993: 326.

allocations, ensures adequate reserves, and organizes projects. Investment is rewarded by NEF with visibility and promotion; NEF admits they "continually acknowledge and promote their investors."[17] NEF sees its role as allowing corporations to broaden their involvement at the community level and give genuine assistance to neighborhood revitalization. Although NEF is a national pool which invests where the funding is most needed, investors may specify a geographical area where they wish to concentrate their investment contribution.

2. Boston Capital

Boston Capital is a real estate investment firm that has been involved in housing investment since 1974. Its activities have involved over 1,600 properties (64,000 units) in 49 states, which includes over 800 LIHTC and tandem tax credit projects. It has raised over $650 million in equity from more than 37,000 investors.[18] Boston Capital links up with development projects in a different manner from the National Equity Fund. Instead of working with CDCs, Boston Capital seeks out (through a variety of methods) developers' projects already in place and offers them a percentage of a dollar's worth of credit. Credits

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17 National Equity Fund, <u>1993 Limited Partnership Executive Summary</u> (Chicago: National Equity Fund, 1993), 2.
18 Boston Capital, <u>Boston Capital Corporate Tax Credit Fund II Investment Summary</u> (Boston: Boston Capital, 1993), 7.

are allocated by the state to local developers for specific low-income-housing projects and Boston Capital then bundles together a group of projects and sells investment units of $1 million to finance the construction. (For comparative purposes, minimum "units" sold to individual investors at Boston Capital are $2,500.) About $500 million of such units are sold annually.[19] A typical series is $100 million that develops 40 to 50 projects.[20]

Cherie Iappini in the Origination Department of Boston Capital stated in an interview with the author that every deal is structured differently, because of the varying requirements of the developers. For example, sometimes Boston Capital will take the proactive role and contact the state housing agency for developers requesting allocations in the case of the LIHTC or contact the National Park Service for a list of developers who have submitted certification applications (usually Part 2), in the case of the HRTC. Boston Capital will then approach the developer about purchase of the credits once allocated. But, she says, usually the developer comes to Boston Capital with a proposal. The developer envisions the project, calls Boston Capital and the developer begins to put together a financing

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19 William Giese, "A real estate tax shelter the IRS can't touch," Kiplinger's Personal Finance Magazine 47 (March 1993): 64.
20 Cherie Iappini, Origination Department, Boston Capital, telephone conversation with author, 9 June 1994.

deal from a number of sources, proposing Boston Capital's equity from purchase of both credits.

Once the developer has found other sources of funding that could be leveraged with Boston Capital's purchase, he or she comes back to Boston Capital to see if it is are still interested in the project. If the project looks like a sound investment, Boston Capital will create a "letter of interest" to give to the developer, which will be submitted to the state housing finance agency to apply for credit allocation. Having a commitment of funding is a requisite before allocation. (Evidence of funding is not a requisite of HRTC certification.) After the allocation comes in from the state, Boston Capital reviews the project, and, if the entire project looks sound, informs the developer who then goes ahead and reserves credits from state. Credits in hand and with an equity commitment from Boston Capital, the developer then can obtain the loans and other funding that are leveraged on Boston Capital's purchase equity. The developer does all the work; Boston Capital only comes in at the end to purchase percentage shares of the tax credit allocation.

Boston Capital thus does not directly get involved in the construction side of tax credit projects, but rather supplies the cash. Development compliance with the HRTC and

LIHTC requirements is left to the developers, and in this regard Boston Capital's structure differs greatly from the National Equity Fund which deals directly with the CDCs in construction and technical assistance matters. Organizations such as Boston Capital play their most important roles as financiers. The corporation's investment is more important than just its dollar face-value; that investment has the power to leverage at least as much money as the credit. (Appendix 10.)

Typically, Boston Capital only has 4 or 5 projects per series that use both the HRTC and the LIHTC; a typical series consists of 150 to 225 projects.[21] If we extrapolate, only 3 percent (at best) use both tax credits. (5 out of 150 projects = 3.3 percent) Obviously, the record of involvement for tandem use is weak, but the opportunity for increased activity exists.

For Boston Capital's Corporate Tax Fund II, the investment structure is as follows: corporations invest as a limited partnership in the "Operating Partnerships" that own and operate affordable housing properties that are expected to qualify for LIHTC. The operating partnerships are formed by local property developers to own and operate the apartment complexes. The limited partnership will contribute the

21 Goldstein, Telephone Conversation with Author. 7 March 1994.

majority of the equity capital and the general partner will contribute the rest.

The tax credit corporate investment programs Boston Capital offers are intended to completely offset capital contributions. Investors usually participate through installment payments, which should give the corporation annual tax benefits equal to or greater than its capital contribution beginning in the first year through tax credits and passive losses. There are minimum contributions to the fund which can be paid in two methods. 1) The all cash method, where money is invested in one lump sum, or 2) the installment method payable in eight installments. (Appendix 12.)

II. Attracting Corporate Investors

A. Why Corporate Investors in Particular?

Preservationists and advocates of low-income housing want to channel corporate money into neighborhood preservation projects through tandem investment in tax credit projects for one simple reason: corporations have the money when many traditional sources do not. The credits are popular with beneficiaries and with Congress: now is the time to tap into these funds because their future appears stable and the returns are high.

Further, the scale of corporate investment dwarfs individuals' dollars invested. Corporate investment fund minimums are typically $1 million or more such as with Boston Capital; the magnitude of such dollars is undeniable. Corporate investors also tend to gravitate toward larger projects, most likely since such large amounts of money are involved. National Park Service statistics on the HRTC show a tendency of corporations to most often undertake projects of over $1 million while individuals most often undertake projects costing between $20,000 and $100,000.[22] Thus, if even a handful more corporations invested in tax credit projects of over $1 million, each corporate investor brought in would bring far more dollars per entity than would most individuals. It is these dollars into which preservationists have not yet tapped.

B. How Do We Attract Corporate Investors?

Tim Barry, President of the St. Louis Equity Fund, a local equity fund, states that the methods with which to attract corporate investors depend upon the goal desired.[23] He says that, if the HRTC/LIHTC project is a one-time deal, then the best approach is to woo the corporation on the community benefits. A one-time project of $1 million is "small potatoes" to a corporation such as Anheuser-Busch (one of

22 Esherich, "Tax Incentives for Rehabilitation Fiscal Year 1993 Analysis," 25.
23 Barry, "Innovative Financing."

St. Louis Equity Fund's local investors), so the corporation would most likely not undertake the one-time project as an investment, per se. Community benefit and good will is the logical rationale. On the other hand, if a group such as a local equity fund wants to do develop projects as an ongoing endeavor, then, Barry says, the approach to take is the financial return of investment.

Cherie Iappini of Boston Capital finds that corporations tend not to invest in a single deal, "but rather invest in a series."[24] If that is the case, there are a number of factors to consider. To attract corporations as investment partners, Barry states that "stability, experience and integrity" are vitally important. Corporations must be assured that the investment is financially sound and the return is competitive because tandem tax credits projects must still compete with other real estate offerings.

1. Advantages to Corporate Investment in the HRTC and LIHTC

a. High Financial Return

Above all else the tax credit project must obviously be a sound financial investment with a favorable return. Tandem use of the credits means increased credits. Jeff Goldstein states that using the two credits together is desirable because the HRTC gives a "kick" to tandem projects by

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24 Iappini, telephone conversation with author, 9 June 1994.

creating an immediate credit return in the first year.[25] Since LIHTC projects produce credits over a longer period of time, tandem credit projects may appease more impatient investors.

Boston Capital describes the benefits of corporate investment in their corporate tax credit funds as follows:[26]

- tax credits, which reduce overall tax liability
- tax losses, such as depreciation
- cash distributions, from possible sale of property
- capital appreciation of property

Boston Capital presents the benefits of investment as increasing net cash flow and corporate earnings per share by investing "dollars that would have otherwise been used to pay taxes."[27]

Most importantly, the rates of return for corporate investment are attractive, ranging from 14 percent to 19 percent, which is at present far higher than all other forms of investments, such as stocks which currently have an average annual return of 2.6 percent or long-term bonds (such at 30-year Treasury bonds) which currently yield an

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25 Goldstein, Telephone Conversation with Author. 7 March 1994.
26 Boston Capital, Boston Capital Corporate Tax Credit Fund II Investment Summary, 1.
27 Boston Capital, Boston Capital Corporate Tax Credit Fund II Investment Summary, 1.

average of 6.9 percent.[28] Rates of return are higher largely because corporations are not subject to passive activity loss limitations, and therefore have money that otherwise would go toward taxes. An enhanced financial statement is thereby anticipated, as the investment in the partnership would enable the corporation to represent the tax credits as a reduction in corporate tax liability, thereby increasing book earnings.[29] Boston Capital also expects increased investor equity in the property through amortization of mortgage indebtedness and potential increases in the value of the apartment complexes leading to cash distributions upon sale or refinancing of the properties.[30]

b. Stable Investment / Low-Risk

Now that the LIHTC has been made permanent, the number of investors appears to be increasing. Cherie Iappini of Boston Capital states that "the corporate market is definitely strong" and they see "more and more first-time investors every year."[31] Boston Capital sees this as a result of the education they have given to corporations.

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28 "PHA rate of vacancy still rising," Philadelphia Inquirer, March 31, 1994.

29 Wallace L. Scruggs, "Effect of Corporate Investment in Low-Income Housing Tax Credit Properties," in Boston Capital Corporate Tax Credit Fund II Investment Summary (Boston: Boston Capital, 1993), 1.

30 Boston Capital, Boston Capital Corporate Tax Credit Fund II Investment Summary, iii.

31 Iappini, telephone conversation with author, 9 June 1994.

Fred Copeman, a senior tax manager at Ernst & Young, has said that non-market rate projects are not as risky as is perceived by developers.

> The principal reason for this is that local housing finance agencies or other government bodies acting as lenders... tend to be more patient than market rate lenders. They'll put a lot of effort into restructuring debt to keep a troubled project from going under.[32]

Investment firms are also trying to counteract the reputation limited partnerships received in the 1980s as risky ventures. To the contrary, limited partnerships limit the amount of liability with which an investor can be charged.

> There is very little risk involved in a corporate investment in a low income housing limited partnership. By the very nature of limited partnerships, the limited partner gives up the right to control or influence activities in return for limited liability. Most limited partnership agreements can be structured to limit liability of the limited partner to its capital contributions.[33]

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32 William G. MacRostie, "The Historic Rehabilitation Tax Credit," (Fact Sheet, Photocopy, 1994), 2.
33 Earl C. Brewer, Jr., "Corporate Investments in Low Income Housing -- High Return, Low Risk, Fast Payback," Journal of Taxation (January 1989): 2 Photocopy reproduced in Boston Capital Corporate Tax Credit Fund II Investment Summary.

c. Public and Employee Relations and Social Responsibility

While financial returns are the major incentive for tax credit use, financial reasons alone are not always sufficient impetus for corporate investors. Additional attractions include public and employee relations. Incentives may assist corporations in promoting an image of social responsibility to their customers. The corporate investor is seen as providing an important social benefit by helping to house the homeless, preserving our architectural heritage, or by satisfying local housing needs, thereby "maintaining a favorable public image."[34] Such gestures are popular in the current business climate and looked upon kindly by the socially-conscious investor. Further, this advertising is often free, through newspaper articles or the like. The NEF goes one step further, by their own admission, to actively publicize the names of its corporate investors through press releases, press conferences, etc.

Corporate investment in tax credit projects can assist in employee relations in a number of ways. Firstly, affordable low-income housing nearby to the company can benefit lower-salaried employees, such as service employees, by providing housing near the place of business. It is in the interest of corporations and companies to provide affordable housing

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34 Novogradac and Fortenbach, Low-Income Housing Tax Credit Handbook, 2--18.

to meet the needs of their employees: when employees go to work for another company with access to more affordable housing, a corporation loses its investment in its human resources.

Another aspect of employee relations which can benefit from investment is the "opportunity to mollify political concerns."[35] Michael Novogradac, of Spectrum Associates, notes the ability of investments in low-income housing to ease community reaction to a corporate action. "For instance, the company may have recently been found to have engaged in age discrimination practices... An investment in a low-income housing project is one way to demonstrate a company's concern for the public good"[36] and focuses attention on the corporation's favorable activities while taking attention away from activities handled less-favorably and can be a way to "make up for" past wrongs.

The tax credit itself can also be a direct employee benefit. For example, employees with an adjusted gross income of less than $250,000 may receive tax benefits from tax credit projects. Novogradac states that, "corporations can invest in [such] projects and give a portion of the project to various executives as additional compensation. The

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35 Ibid., 2--17.
36 Ibid., 2--19.

executives would then realize the compensation over time as they claim the associated tax credits on their personal income tax returns."[37] This might make it too "expensive" for an employee to leave the corporation. This arrangement is a creative way of using the credit, but does have the drawback of "handcuffing" the employee to the employer if the employer makes receipt of the credits subject to recapture should the employee depart from the corporation before the compliance period has expired. Conversely, the corporation could be hindered by being unable to terminate the employee before the compliance period has expired.

d. Community Revitalization Act Requirements

As a result of the Community Revitalization Act of 1977, financial institutions must demonstrate that they serve the communities in which they are chartered to do business.[38] One way of doing this is to invest in their local area for the public good, and tax credit projects do just that.[39] The Act was intended to counteract discriminatory "red-lining" activities and to promote lending in communities that had been perceived to have been overlooked due to geographic biases.

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37 Ibid.

38 Michael Novogradac and Eric J. Fortenbach, "A Low-Income Housing Alternative," Mortgage Banking 50, No. 6 (March 1990): 51

39 Novogradac and Fortenbach, Low-Income Housing Tax Credit Handbook, 2--18

2. Disadvantages to Corporate Investment in the HRTC and the LIHTC

a. "Illiquid" Investment

One consideration to be kept in mind with regard to LIHTC projects is that the money will be tied up for as long as 30 years. This is a disadvantage, but it is typical of limited partnerships. These limited partnerships are "illiquid - tough to sell on short notice."[40] So, if an investor needs to be liquid, limited partnership investment in these tax credits is not particularly attractive.

b. Loss of Control Over Investment

The biggest risk area for a corporate investor in a leveraged limited partnership might be that the capital contributions will not be returned if the project fails. This risk is lessened if the project is well-researched beforehand. Cherie Iappini of Boston Capital states that a limited partnership is sometimes perceived as a risk, in large part due to the reputation they received in the 1908s as unsafe investments. She believes that education continues to dispel investor fears, but that they are "not over that hump yet."[41]

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40 Giese, "A real estate tax shelter the IRS can't touch," 63.
41 Iappini, telephone conversation with author, 9 June 1994.

c. Possibility of Bad Publicity

The issue of corporate responsibility arises when evaluating any investment option. Real estate ventures are often seen as risky and the result of a bad investment is not only money lost but angry stockholders. Angry stockholders can affect future investment activity negatively by a loss of faith in the corporation's ability to invest wisely. Tim Barry states that, for a corporation, bad publicity over a failed or misdirected investment is even worse than the money lost in the project,[42] because word of botched development projects appears in the news and is spread by word of mouth. To be linked with a failed project is unnecessary bad publicity.

d. Compliance Burdens and Risk

The sheer number of requirements of tax credit projects can be a disadvantage not only because the administrative work is burdensome, but also because the volume of regulations creates myriad opportunities to err. For example, tenants' incomes must be monitored so that they do not rise above acceptable levels, the set-aside ratios must be met, and so forth. Compliance burdens are acknowledged to be heavy. But, because the investment is real capital and not grants, the private sector ends up having a long-term concern about

42 Barry, "Innovative Financing."

the fate of these investments. As Paul Grogan, LISC President, has said, this

> creates incentives for good management, for solving problems as they arise, and for not putting off...things that should be dealt with now. These are attributes of private investment that are going to be...helpful in producing a durable result for the families that are benefitting from this housing, as well as their communities.[43]

Although the compliance requirements are stringent, they produce a product that does what it is supposed to do: preserve housing in neighborhoods.

Further, corporations themselves already have hierarchical administrative burdens and the levels of personnel between the private developer and the corporate executive can be many; negotiating the maze of corporate paths in addition to tax credit paths can be overwhelming. This is why people knowledgeable of the credits are vitally important to the success of credit projects.

e. Limited Use Per Corporation

Cherie Iappini states that there is a limit to how much money any one corporation will want to invest in tax credits. She says, "corporate use won't 'jump up' because [they] can only buy so much credit." A corporation, like any investor, needs a diversified portfolio, and so is "not

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43 National Equity Fund, 1992 Annual Report, 8.

going to lump [their investment dollars] into [only] one place."[44] If this is the case, then promotion of tax credit investment should focus on attracting new corporations as well as encouraging current investors to increase their investments.

C. Encouraging Increased Corporate Investment

Taking the above advantages and disadvantages into consideration, there are a number of activities, mostly concerned with public relations, that can encourage corporate investors. The success of tax credit projects cannot be overlooked as a selling point in itself. Tax credits increase corporate earnings, enhance stock value, and is socially responsible. Promoted as a long-term benefit to the corporation, tax credit projects can be presented as equally good investments as other types of investments.

A proper understanding of the nature of the National Register of Historic Places must be fostered in investors and developers. Cherie Iappini of Boston Capital has said that "many buildings are just not eligible for historic status."[45] The popular belief is that a building must be architecturally significant to be eligible for the National

44 Iappini, telephone conversation with author, 9 June 1994.
45 Iappini, telephone conversation with author, 9 June 1994.

Register, but buildings may be significant for other reasons which also make them eligible, such as being the location of a historic event or as a typical example of a place and time. It is not as difficult for a building to be eligible for listing on the National Register of Historic Places as is popularly believed and this must be made known so that developers and investors will not shy away from older properties.

As addressed above, since corporations invest such large sums of money, they tend to invest in larger projects. This is not always beneficial for neighborhoods that consist of smaller buildings. Large apartment buildings or lofts for conversion to apartments are not always readily available in all neighborhoods, even though these larger projects are typical of those in which corporate investment is found. Increased community development corporation involvement, such as occurs with the National Equity Fund, can be part of the solution to this problem. Another solution is to build coalitions between CDCs or smaller developers' projects to create larger project pools which corporations would find more attractive. "Packages" of smaller projects could be promoted to syndicators such as Boston Capital.

Above all, bringing this accelerating trend of corporate investment to the attention of preservationists and to the

attention of potential investors is the simplest and most effective method of increasing usage. Familiarity with the credits and their benefits as competitive investments is the first, and the steepest, step toward widespread use.

CHAPTER 5.

CONCLUSION

The purpose of this thesis was to bring the growing trend of investment by widely-held corporations in the Historic Rehabilitation Tax Credit and the Low-Income Housing Tax Credit to the attention of preservationists and advocates of affordable housing. Preservationists must understand and accept the state of financing today and educate private investors to join in; preservation can readily use those funds. While renters' incomes continue to drop while rents increase and traditional funding sources, such as commercial banks and savings and loan associations, disappear, corporate investors have become candidates to help fill this funding gap.

Although corporate investment has only comprised between 10 percent and 17 percent of the total Historic Rehabilitation Tax Credit investor pool since 1986, corporate investment has shown a steady increase over that time period. And, when it is understood that even though corporate investors comprise only a small percentage of investor types, corporations invest far greater amounts of money for each percentage point than may any individual investor. Preservationists should not dismiss corporate involvement because it currently comprises only a small piece of the

investment pie, but rather should recognize that corporate investment funds could increase exponentially the total investment in historic rehabilitation and low-income housing. Therefore, preservationists and housing advocates should supply themselves with information with which to woo corporate investors.

Recent amendments to the Internal Revenue Code have made corporate investment one of the few remaining investor pools for tax credit projects. The Tax Reform Act of 1986 devastated the individual investor pool by creating passive activity loss limitations and income ceilings on investors. As a result, high-income investors were lost, and with them, significant amounts of funding for historic rehabilitation and low-income housing projects. However, corporate investors are <u>not</u> subject to any such limitations, and since corporations tend to invest in larger projects, their investment funding can help to fill the void that has been created by the exclusion of high-income individual investors.

In order to understand how and why tandem tax credits are attractive to investors as well as to preservationists and affordable housing advocates, this study presented the technical requirements of each credit as well as the requirements of tandem use. The most important resultant

requirements of tandem use are that the building be historic and that it be held for use as rental housing. This outcome directly addresses low-income renters who live in older neighborhoods and provides relief specific to their situation. Although tandem use of these two tax credits is not a solution for all low-income housing needs and it is not a solution for all historic preservation needs, tandem use can be greatly beneficial in certain circumstances, such as older, lower-income neighborhoods. Preserving the physical component of a neighborhood retains housing and provides employment while promoting revitalization. In this context, the two tax credits truly serve their intended purpose; they encourage private investment in projects concerned with the public good while physically retaining and rehabilitating housing. With tandem use of the credits on the rise, the time is ripe for increased use.

This thesis has also examined the nature of corporate investment in tax credit projects and the motivations for doing so. Primarily motivated by high returns on their investments, corporations also find tax credit investment attractive because it provides long-term stability and brings them favorable publicity targeted at their socially-conscious customers.

In order to demonstrate the mechanisms for large-scale corporate investment, this thesis presented case studies on the National Equity Fund and Boston Capital to illustrate the methods used by corporations and syndicators to channel investment funds into the tax credit projects. Corporations do not typically invest directly in low-income housing and historic rehabilitation projects, but rather invest with syndicators and equity funds which sell investment units and then pool the money for distribution over a number of projects. The National Equity Fund (NEF) works with local Community Development Corporations to fund and broker projects and provide technical assistance. The NEF targets Fortune 500 corporations as its investors, and 108 corporations have invested $620 million in the fund since 1987. Boston Capital operates in a different manner from NEF, in that Boston Capital links up with developers' projects already in progress and offers the developer a percentage per dollar of the credit. Boston Capital then bundles together tax credit projects and sells corporate investment units of $1 million each to finance the construction. About $500 million of such units are sold annually.

Such high amounts of money are invaluable as they can be used to leverage as much as three times the amount from other funding sources. Thus, corporate investment is not

only important because is generates large amounts of money for housing preservation, but is also important because it also allows large sums of money to be leveraged, without which many projects would not be viable.

This thesis also provided specific suggestions for increasing awareness of corporate investment. Corporate investors need to feel that the investment is secure and will provide a high rate of return. The investment project must be sound because if a project fails, the result is not only money lost, but also loss of shareholders' confidence and negative publicity.

At the bottom line, a significant sum of corporate money will be invested, with or without the use of the Historic Rehabilitation Tax Credit or the Low-Income Housing Tax Credit. Why not tap into these funds? Familiarity with the credits and their benefits as competitive investments is the first, and largest, step toward widespread use. It is up to preservationists to make neighborhood preservation -- through investment in the HRTC and the LIHTC -- attractive to corporate investors.

APPENDIX 1.

NATIONAL REGISTER CRITERIA

Significance may found in four aspects of American history:

A. Property is associated with events that have made a significant contribution to the broad patterns of our history.

B. Property is associated with the lives of persons significant in our past.

C. Property embodies the distinctive characteristics of a type, period, or method of construction or represents the work of a master, or possesses high artistic values, or represents a significant and distinguishable entity whose components lack individual distinction.

D. Property has yielded, or is likely to yield, important information about prehistory or history

APPENDIX 2.

THE SECRETARY OF THE INTERIOR'S STANDARDS FOR REHABILITATION

The following Standards are to be applied to specific rehabilitation projects in a reasonable manner, taking into consideration economic and technical feasibility.

1. A property shall be used for its historic purpose or be placed in a new use that requires minimal change to the defining characteristics of the building and its site and environment.

2. The historic character of a property shall be retained and preserved. The removal of historic materials or alteration of features and spaces that characterize a property shall be avoided.

3. Each property shall be recognized as a physical record of its time, place, and use. Changes that create a false sense of historical development, such as adding conjectural features or architectural elements from other buildings, shall not be undertaken.

4. Most properties change over time; those changes that have acquired historic significance in their own right shall be retained and preserved.

5. Distinctive features, finishes, and construction techniques or examples of craftsmanship that characterize a property shall be preserved.

6. Deteriorated historic features shall be repaired rather than replaced. Where the severity of deterioration requires replacement of a distinctive feature, the new feature shall match the old in design, color, texture, and other visual qualities and, where possible, materials. Replacement of missing features shall be substantiated by documentary, physical, or pictorial evidence.

7. Chemical or physical treatments, such as sandblasting, that cause damage to historic materials shall not be used. The surface cleaning of structures, if appropriate, shall be undertaken using the gentlest means possible.

8. Significant archeological resources affected by a project shall be protected and preserved. If such resources must be disturbed, mitigation measures shall be undertaken.

9. New additions, exterior alterations, or related new construction shall not destroy historic materials that characterize the property. The new work shall be compatible with the massing, size, scale, and architectural features to protect the historic integrity of the property and its environment.

10. New additions or adjacent or related new construction shall be undertaken in such a manner that if removed in the future, the essential form and integrity of the historic property and its environment would be unimpaired.

APPENDIX 3.

Low-Income Housing Tax Credit Monthly Percentages

The monthly percentages determined by IRS under Code Sec. 42(b) for buildings placed in service after '87 are as follows:

Month	Year	70% present value credit	30% present value credit:
Apr.	'94	8.48%	3.63%
Mar	'94	8.37	3.59
Feb.	'94	8.37	3.59
Jan	'94	8.36	3.58
Dec.	'93	8.30	3.56
Nov.	'93	8.26	3.54
Oct.	'93	8.27	3.54
Sept.	'93	8.36	3.58
Aug	'93	8.37	3.59
July	'93	8.42	3.61
June	'93	8.38	3.59
May	'93	8.40	3.60
Apr.	'93	8.40	3.60
Mar	'93	8.51	3.65
Feb.	'93	8.57	3.67
Jan.	'93	8.60	3.69
Dec.	'92	8.59	3.68
Nov.	'92	8.49	3.64
Oct.	'92	8.50	3.64
Sept.	'92	8.55	3.66
Aug.	'92	8.65	3.71
July	'92	8.72	3.74
June	'92	8.76	3.75
May	'92	8.77	3.76
Apr.	'92	8.75	3.75
Mar.	'92	8.68	3.72
Feb.	'92	8.61	3.69

FEDERAL TAX COORDINATOR 2d

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Month	Year	70% present value credit	30% present value credit
Jan	'92	8.70	3.73
Dec.	'91	8.76	3.76
Nov	'91	8.78	3.76
Oct	'91	8.85	3.79
Sept.	'91	8.94	3.83
Aug	'91	8.99	3.85
July	'91	8.95	3.83
June	'91	8.92	3.82
May	'91	8.93	3.83
Apr.	'91	8.91	3.82
Mar	'91	8.89	3.81
Feb.	'91	8.93	3.83
Jan.	'91	8.96	3.84
Dec.	'90	9.06	3.88
Nov.	'90	9.13	3.91
Oct.	'90	9.13	3.91
Sept.	'90	9.05	3.88
Aug.	'90	9.05	3.88
July	'90	9.07	3.89
June	'90	9.16	3.93
May	'90	9.08	3.89
Apr	'90	9.07	3.89
Mar.	'90	9.03	3.82
Feb.	'90	8.91	3.82
Jan.	'90	8.89	3.81
Dec.	'89	8.91	3.82
Nov.	'89	8.97	3.85
Oct.	'89	8.98	3.85
Sept.	'89	8.92	3.82
Aug	'89	8.97	3.84
July	'89	9.07	3.89
June	'89	9.21	3.95
May	'89	9.27	3.97
Apr.	'89	9.26	3.97
Mar	'89	9.19	3.94
Feb	'89	9.22	3.95
Jan	'89	9.20	3.94
Dec.	'88	9.12	3.91
Nov.	'88	9.14	3.92
Oct.	'88	9.22	3.95
Sept.	'88	9.19	3.94
Aug	'88	9.14	3.92
July	'88	9.17	3.93
June	'88	9.13	3.91
May	'88	9.04	3.87
Apr.	'88	8.96	3.84
Mar.	'88	8.99	3.85
Feb.	'88	9.12	3.91
Jan.	'88	9.15	3.92

APPENDIX 4

Pennsylvania Housing Finance Agency

Housing Priorities and Selection Criteria

from: Pennsylvania Housing Finance Agency, Federal Low Income Rental Housing Tax Credit Program Guide

HOUSING PRIORITIES

The Agency will only accept applications in the specific cycle from developers who address the housing priorities as set forth below. All priorities listed will be given equal preference.

CYCLE 1

The Agency will accept applications during Cycle 1 that have the following characteristics:

1. Proposals which produce additional units of housing for families through new construction or substantial rehabilitation. At least 75% of the units in the project must have two or more bedrooms. The project cannot contain less than three units.

   A project is considered to be undergoing substantial rehabilitation if more than one major building component is being replaced. See Program Guide for further definition of major building components.

2. Proposals which produce additional units of housing for the elderly through new construction or substantial rehabilitation.

3. Proposals which address the needs of the homeless through transitional or permanent housing.

4. Proposals which address the needs of persons with a physical and/or mental disability.

5. Proposals which address the needs of migrant farmworkers.

6. Proposals for the preservation of a project that is on the verge of displacing tenants due to either substandard housing conditions or an impending conversion to market rate housing. There must be a change in ownership entities and sufficient documentation of the probability of displacement. The Agency will use its own discretion in determining the adequacy of the submitted information. Proposals must contain a long range support service plan for the tenants, that includes assessment of current tenant needs.

CYCLE 2

The Agency will accept applications during Cycle 2 that have the following characteristics:

1. Proposals which produce additional units of housing for families through new construction or substantial rehabilitation or prevent displacement of families. At least 50% of the units of the project must have two or more bedrooms.

   A project is considered to be undergoing substantial rehabilitation if more than one major building component is being replaced. See Program Guide for further definition of major building components.

2. Proposals which produce additional units of housing for the elderly through new construction or substantial rehabilitation or prevent displacement of the elderly.

3. Proposals which address the needs of the homeless through transitional or permanent housing.

4. Proposals which address the needs of persons with a physical and/or mental disability.

5. Proposals which address the needs of migrant farmworkers.

6. Proposals for the preservation of a project that is on the verge of displacing tenants due to either substandard housing conditions or an impending conversion to market rate housing. Sufficient documentation of the probability of displacement must be submitted. Proposals must contain a long range support service program for the tenants.

CYCLE 3

All applications that qualify for tax credits will be accepted. Preference will be given to those projects addressing the priorities listed in the first two cycles.

SELECTION CRITERIA

Prior to evaluating a project based on the selection criteria stated below, the Agency will first review the project's construction costs, fees and operating expenses and the project's financial feasibility and long term viability. Applications found to be acceptable will then be ranked according to the selection criteria stated below. The criteria is listed in order of priority within the categories. A project which fails to address a sufficient number of criteria will not rank high enough to be considered for tax credits.

A. Financial Assistance

1. Proposals which use the highest percentage of the housing credit dollars for costs other than intermediary costs. Intermediary costs include, but are not limited to: syndication costs, attorney fees, architectural fees, consultant fees, organizational costs and engineering fees.
2. Proposals which reflect a lower developer's fee than the Commonwealth's maximum allowable percentages, or which demonstrate a substantial commitment of developer funds to support project operations.
3. Projects which receive significant funding from state and local programs, nonprofit organizations, private foundation funds, and/or federal programs. Such funding must be in the form of grants or loans below applicable federal rates.
4. Projects which have already received a firm commitment for financing from a financial institution.

B. Rent Affordability

1. Projects to be fully occupied by tenants whose incomes are at or below 50% of area median income.
2. Projects to be substantially occupied by tenants whose incomes are at or below 50% of area median income.
3. Developers who receive a commitment from the local public housing authority to provide the project with tenants from the public housing waiting list.
4. Projects which will maintain rent levels below the maximum levels established for this program. Proposals which indicate lower rents must be financially feasible at the lower rents.

C. Project Considerations - The Agency will not consider projects which have resulted or will result in the displacement of existing low-income tenants.

1. Willingness of the developer to execute a commitment to retain the elected set-aside of low-income units of the project for a 30 year period.

2. Proposals which can demonstrate the participation of a local tax-exempt organization.

3. Proposals demonstrating a significant commitment to, and the ability to meet the needs of, one of the following special needs group: physically or mentally disabled; migrant workers; homeless; or the very low-income. Evidence of a significant commitment includes but is not limited to: a financial commitment; a long range supportive services plan; or a social service provider having a role in project management or as part of the ownership.

4. Projects that have received a letter of support from the chief elected official of the local government.

D. Development Team

1. Projects having a developer who has had previous experience in developing the type and size of project being proposed.

2. Projects retaining a management agent with previous experience in managing low-income housing units.

3. Projects having a development team component whose firm has been designated a Woman's Business Enterprise or a Minority Business Enterprise. A nonprofit organization whose Board is comprised of minorities or female members.

Projects receiving the highest ranking for each area will then be evaluated to determine the amount of tax credit dollars required to make the project economically feasible and to ensure the project's long term viability.

The Agency's determination as to the amount of tax credits required shall not be construed by the developer, lender, or any other interested party to be a warranty of the project's feasibility and viability, nor shall such determination constitute a representation of compliance with any requirements of the Code.

APPENDIX 5

1993 TAX CREDIT UTILIZATION
(in dollars and number of units)

Allocating Agency	Per Capita Credits	Total 1993 Credits †	Total Allocations	Low Income Units
Alabama	5,170,000	13,309,778	6,145,387	2,647
Alaska	733,750	733,750	733,750	120
Arizona	4,790,000	9,223,391	9,223,391	478
Arkansas	2,998,750	4,572,237	3,776,820	1,349
California	38,583,750	70,434,569	70,434,569	9,001
Colorado	4,337,500	5,563,945	5,563,945	889
Connecticut	4,101,250	10,148,044	2,831,468	322
Delaware	861,250	1,157,107	1,157,107	320
District of Columbia	736,250	2,096,858	2,096,858	919
Florida	16,860,000	30,946,761	30,946,761	6,452
Georgia	8,438,750	14,974,969	9,391,562	3,764
Hawaii	1,450,000	1,975,897	1,975,897	183
Idaho	1,333,750	1,783,381	1,783,381	410
Illinois	14,538,750	17,968,671	15,628,583	3,531
Indiana	7,077,500	12,214,231	3,737,235	861
Iowa	3,515,000	7,455,499	5,493,867	1,820
Kansas	3,153,750	5,362,894	5,362,894	1,989
Kentucky	4,693,750	6,344,185	4,238,303	1,519
Louisiana	5,358,750	9,574,387	8,286,888	2,542
Maine	1,543,750	2,262,200	769,027	200
Maryland	6,135,000	9,976,837	9,923,369	1,938
Massachusetts	7,497,500	12,776,894	9,364,002	1,274
Michigan	11,796,250	22,603,396	15,861,460	4,068
Minnesota	5,600,000	5,673,067	5,656,766	1,789
Mississippi	3,267,500	7,422,491	1,721,338	1,297
Missouri	6,491,250	13,896,404	8,136,877	2,282
Montana	1,030,000	1,030,000	395,608	89
Nebraska	2,007,500	3,402,234	2,165,991	651
Nevada	1,658,750	3,335,820	2,588,089	536
New Hampshire	1,388,750	2,588,417	282,784	73
New Jersey	9,700,000	14,582,350	14,582,350	2,431
New Mexico	1,976,250	3,131,360	3,130,013	376
New York	22,648,750	31,339,699	31,339,699	5,300
North Carolina	8,553,750	11,344,547	4,794,311	1,740
North Dakota	793,000	1,552,098	1,396,888	456
Ohio	13,770,000	22,425,345	22,425,345	6,504
Oklahoma	4,015,000	7,572,922	1,338,485	
Oregon	3,721,250	5,400,505	5,400,505	1,652
Pennsylvania	15,011,250	32,810,010	14,152,475	2,677
Puerto Rico	4,402,546	6,476,543	1,013,919	661
Rhode Island	1,256,250	3,425,485	3,379,819	912
South Carolina	4,503,750	7,576,121	3,938,160	1,313
South Dakota	888,750	1,142,589	1,119,520	354
Tennessee	6,280,000	12,163,030	8,385,153	2,869
Texas	22,070,000	35,745,114	35,392,326	15,475
Utah	2,266,250	4,250,791	4,250,791	974
Vermont	712,500	1,051,414	361,283	229
Virgin Islands	127,261	163,864	0	0
Virginia	7,971,250	12,879,191	12,879,191	3,489
Washington	6,420,000	7,414,252	7,414,252	1,609
West Virginia	2,265,000	3,911,081	427,889	271
Wisconsin	6,258,750	7,287,914	545,034	84
Wyoming	582,500	1,915,773	1,158,592	213
TOTAL	323,344,807	546,370,512	424,701,977	102,926

Note: Total activity does not include projects financed with tax-exempt bonds
† Equals Per Capita + Returned + Carryover + National Pool Credit Authority

Source: National Council of State Housing Agencies

PENNSYLVANIA HOUSING FINANCE AGENCY
LOW-INCOME RENTAL HOUSING TAX CREDIT PROGRAM
Income Limits / Rents at 50% and 60% of 1993 Area Median Income

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INCOME LIMITS
PHILADELPHIA REGION $46,600 Median Income
(Bucks, Chester, Delaware, Montgomery, and Philadelphia)

HOUSEHOLD SIZE

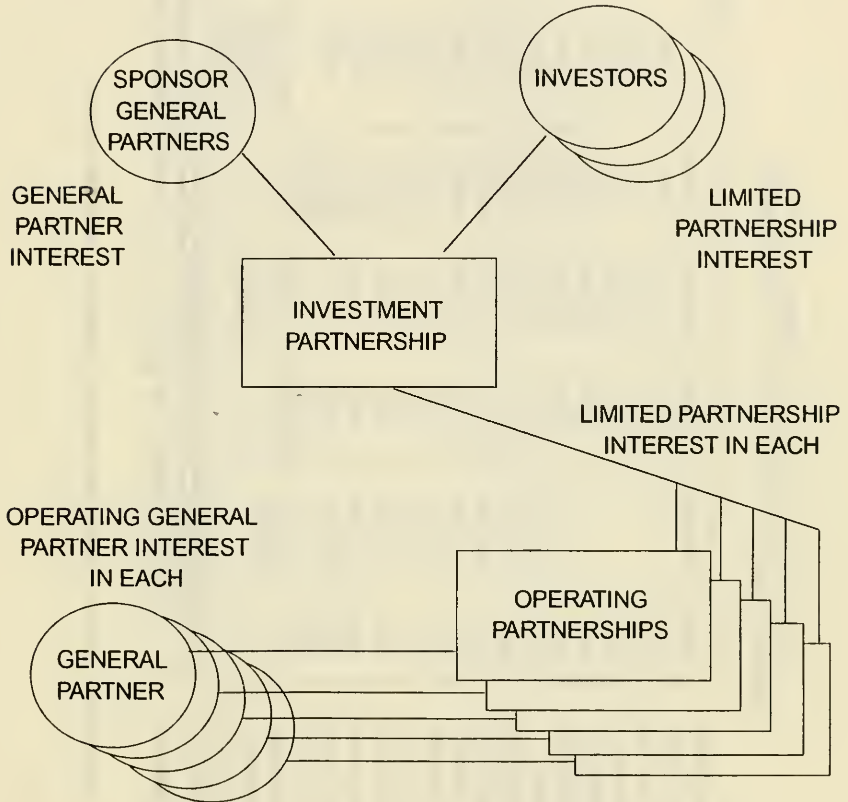
% of Median	1 Person	2 Person	3 Person	4 Person	5 Person	6 Person	7 Person	8 Person
50	$16,300	18,650	20,950	23,300	25,150	27,050	28,900	30,750
60	$19,500	22,380	25,140	27,960	30,180	32,460	34,680	36,900

RENTS

% of Median	EFF./SRO	1 BR	2 BR	3 BR	4 BR	5 BR
50	$407	436	523	605	676	745
60	$489	524	628	726	811	894

Source: Pennsylvania Housing Finance Agency
Effective 5/5/93

TWO-TIERED LIMITED PARTNERSHIPS



Adapted from John C. McCarthy, "Corporate Investment in Low-Income Housing Partnerships." Real Estate Finance (Spring 1990).

National Equity Fund Estimated Payments and Benefits

Payments and Benefits

Payments for limited partnership interests are made over an eight-year period for a ten-year stream of tax credits and 15 years of passive losses. Average annual tax savings during the pay-in period are projected to be 100% of annual payments. First payment will be made April, 1994. The internal rate of return (IRR) is projected at 18% over the life of a 15-year partnership.

The accompanying table shows a sample payment schedule and estimated annual tax savings for a $2 million corporate investor. Investments are purchased in $1 million units.

Estimated Payments and Benefits for a $2 Million Corporate Investor

THIS TABLE IS FOR ILLUSTRATION ONLY, AND NOT INTENDED TO BE A PREDICTION OF ACTUAL RESULTS, WHICH WILL DIFFER. *TAX SAVINGS FROM DEPRECIATION AND OTHER OPERATING DEDUCTIONS AT 34% CORPORATE TAX RATE.

Year	Equity Payments	Tax Savings			Cumulative Tax Savings as a % of Equity Payments	Cumulative IRR From Tax Savings
		Depreciation*	Credits	Total		
1993		$21,000		$21,000		
1994	$60,000	39,000		39,000	100.00%	
1995	60,000	58,000	$2,000	60,000	100.00%	
1996	149,000	68,000	81,000	149,000	100.00%	
1997	301,000	60,000	241,000	301,000	100.00%	
1998	297,000	53,000	244,000	297,000	100.00%	
1999	291,000	47,000	244,000	291,000	100.00%	
2000	286,000	42,000	244,000	286,000	100.00%	
2001	279,000	35,000	244,000	279,000	100.00%	
2002	277,000	33,000	244,000	277,000	100.00%	0.0%
2003		32,000	244,000	276,000	113.80%	9.49%
2004		31,000	244,000	275,000	127.55%	14.48%
2005		30,000	243,000	273,000	141.20%	17.53%
2006		30,000	165,000	195,000	150.95%	19.02%
2007-10		94,000		94,000	155.65%	19.56%
TOTALS	**$2,000,000**	**$673,000**	**$2,440,000**	**$3,113,000**		

Effective August 1, 1995, all offering documents have been amended to reflect a nine-year pay-in schedule.

(Source: National Equity Fund 1993 Limited Partnership Executive Summary, p. 8.)

APPENDIX 9

NATIONAL EQUITY FUND CORPORATE INVESTORS

AT&T
Aetna Life & Casualty
American Express Company
Ameritech
Arco
Astoria Federal Savings & Loan
Avery Dennison Corporation
Banc One Community Development Corporation
Bankers Trust
Bank of America NT & SA
Bank of New York
Bear Stearns Companies, Inc.
Boatmen's Bank
The Boeing Company
Bristol-Myers Squibb
The Brooklyn Union Gas Company
CBS, Inc.
California Federal Savings & Loan
Canadian Imperial Bank of Commerce
Capital Cities/ABC, Inc.
Chemical Bank
Chevron Corporation
Citicorp
City National Bank
Consolidated Edison Company of New York, Inc.
The Continental Corporation
Credit Lyonnais
Dime Savings Bank of New York, FSB
Dominion Capital, Inc.
Eastman Kodak Company
East River Savings Bank, a Division of River Bank America
Eli Lilly and Company
Equitable Financial Companies
Federal Home Loan Mortgage Corporation (Freddie Mac)
Federal National Mortgage Association (Fannie Mae)
First Bank System
First Federal Savings Bank of California
First Fidelity Bancorporation
First Interstate Bank
First Nationwide Bank
First of America CDC
Fleet Bank
General Mills, Inc.
Glendale Federal Savings
Graco, Inc.
Great Western Bank
H&R Block, Inc.
Hallmark Cards, Inc.
Home Savings of America
Honeywell, Inc.
IBJ Schroder Bank & Trust Company
INB Financial Corporation
Independence Savings Bank
J.C. Penney Company, Inc.
J. P. Morgan
KTLA, Inc.
Kansas City Life Insurance Company
Kansas City Power & Light Company
Kaufman and Broad Home Corporation
Knight-Ridder, Inc.
Levi Strauss & Company
Manhattan Savings Bank
Mellon Bank, NA
Melville Corporation
Meridian Bank, NA
Midlantic Corporation
National Westminster Bank USA
New York Life Insurance Company
New York Telephone Company
Northern States Power Company
Northwest National Life Insurance Co.
Norwest Investment Services, Inc.
Payless Cashways, Inc.
Pfizer Inc.
Piper Jaffray Companies Inc
Provident National Bank
The Prudential Insurance Company of America
Quantum Chemical Corporation
Republic National Bank of New York
Safra National Bank
The St Paul Companies, Inc.
Salomon Bros., Inc.
Signet Banking Corporation
Society Community Development Corporation
The Stanley Works
TW Services, Inc
The Times Mirror Company
Transamerica Corporation
US Trust Company of New York
United HealthCare Corporation
Walt Disney Co. (Buena Vista TV)
Washington Mutual Savings Bank
Wells Fargo & Company
Westamerica Bancorp
Weyerhaeuser Company
World Book, Inc a Subsidiary of Berkshire Hathaway, Inc
Xerox Corporation

APPENDIX 10

BASIC EXAMPLE USING LOW-INCOME TAX CREDITS 25 UNITS - REHAB

USES	ACTUAL COST	QUALIFIED BASIS FOR 9% CREDIT	QUALIFIED BASIS FOR 4% CREDIT
Construction Costs	$ 1,000,000	1,000,000	
Fees (architect, consultant, etc.)	150,000	150,000	
Miscellaneous (market study, environmental)	50,000	50,000	
Construction Financing (interest, fees, etc.)	120,000	120,000	
Permanent Financing Fees	10,000		
Land	20,000		
Building	100,000		100,000
Developer's fee	200,000	200,000	
Syndicator's fee	50,000		
Total Uses	$ 1,700,000	$ 1,520,000	$ 100,000
		.09	.04
Annual Tax Credit		$ 136,800 +	$ 4,000

Total annual tax credit = $140,800

Equity raise given a $.45 per tax credit dollar offer from syndicator:

Total tax credits over 10 years	$1,408,000
x syndicator offer per tax credit	x.45
Equity to project	$ 633,600

Sources

Equity	$ 633,600
Secondary financing sources (CDBG, HOMES, etc.)	600,000
First Mortgage	$ 466,400
Total Sources	$ 1,700,000

Excerpted from A Developers Guide to Low Income Housing Credits by Herb Stevens, Kelley Drye & Warren and Tom Tracy, KMPG Peat Marwick to be published by the National Council of State Housing Agencies. Photocopied excerpt distributed by Pennsylvania Housing Finance Agency, 1994.

APPENDIX 11

Typical Low-Income Housing Tax Credit Pro Forma Analysis: Funding Schedule

– SOURCES AND APPLICATION OF FUNDS SCHEDULE –

OPERATING PARTNERSHIP:	LIHTC APARTMENTS L.P.	
GENERAL PARTNER	JOE Q. PUBLIC	
DATE:	08-Jun-94	
# OF UNITS	64	
	SOURCES OF FUNDS	
	FINACING #1	$850,000
	FINACING #2	400,000
	CAPITAL CONTRIBUTIONS	
	GENERAL PARTNERS	0
	INVESTMENT PARTNERSHIP	1,775,300
	WORKING CAPITAL LOAN	0
	OTHER	0
		$3,025,300
	APPLICATION OF FUNDS	
	TOTAL CONSTRUCTION COST	$2,121,162
	ARCHITECTURAL FEES	89,300
	SURVEY & ENGINEERING	29,000
	FINANCING COSTS & LOAN FEES	87,000
	INTEREST DURING CONSTRUCTION	36,500
	CLOSING COSTS & LEGAL FEES	11,000
	CONTINGENCY FOR PROJECT	93,400
	LAND COST OR VALUE	4,000
	COST CERTIFICATION	0
	TAX CREDIT APPLICATION	23,338
	MARKET STUDY	6,000
	ENVIRONMENTAL	4,800
	APPRAISAL	4,000
	RENT-UP & OPERATING RESERVE	25,000
	ORGANIZATIONAL EXPENSE	4,500
	BUILDING ACQUISITION	66,000
	OTHER	20,000
	CONSTRUCTION AND DEVELOPMENT FEE	400,300
	CONSTRUCTION FEE INTEREST	0
	DEVELOPER'S OVERHEAD	0
	REPAYMENT OF WORKING CAPITAL LOAN	0
		$3,025,300
	SURPLUS/DEFICIT	$0
	SPECIAL DISTRIBUTION	$0
	RETURN OF CAPITAL	$0

Source: Boston Capital

Typical Low-Income Housing Tax Credit Pro Forma Analysis: Development Cost Summary

– DEVELOPMENT COST SUMMARY –

OPERATING PARTNERSHIP: LIHTC APARTMENTS L.P
GENERAL PARTNER: JOE Q. PUBLIC
FILE: R:\users\iappino\123\edit\lw\hist_expl
DATE: 08-Jun-94
OF UNITS: 64

	TOTAL DEV COSTS	ELIGIBLE LIHTC/ NEW CONST./ REHAB	ELIGIBLE LIHTC/ ACQUISITION COSTS	ELIGIBLE HISTORIC REHAB. COSTS	INELIGIBLE COSTS	DEPRECIATE	AMORTIZE & EXPENSE	DEPRECIABLE LIFE IN YEARS	OTHER
TOTAL CONSTRUCTION COST	$2,121,102	$2,121,162	$0	$2,057,527	$0	$29,000	$0		$0
ARCHITECTURAL FEES	89,300	89,300	0	89,300	0	89,300	0		0
SURVEY & ENGINEERING	29,000	29,000	0	29,000	0	29,000	0		0
FINANCING COSTS & LOAN FEES	87,000	0	0	0	87,000	0	87,000		0
INTEREST DURING CONSTRUCTION ^^^	36,500	36,500	0	36,500	0	36,500	0		0
CLOSING COSTS & LEGAL FEES	11,000	11,000	0	11,000	0	11,000	0		0
CONTINGENCY FOR PROJECT	93,400	93,400	0	93,400	0	93,400	0		0
LAND COST OR VALUE	4,000	0	0	0	4,000	0	0		4,000
COST CERTIFICATION	0	0	0	0	0	0	0	5.0	0
TAX CREDIT APPLICATION	23,338	23,338	0	0	0	23,338	0	5.0	0
MARKET STUDY	6,000	6,000	0	6,000	0	6,000	0	5.0	0
ENVIRONMENTAL	4,800	4,800	0	2,400	0	4,800	0	5.0	0
APPRAISAL	4,000	4,000	0	2,000	0	4,000	0	5.0	0
RENT-UP & OPERATING RESERVE	25,000	0	0	0	25,000	0	25,000	5.0	0
ORGANIZATIONAL EXPENSE	4,500	0	0	0	4,500	0	4,500	5.0	0
BUILDING ACQUISITION	66,000	0	66000	0	0	66,000	0	27.5	0
OTHER	20,000	20,000	0	20,000	0	20,000	0	5.0	0
TOTAL	$2,623,000	$2,438,500	$66,000	$2,347,127	$120,500	$412,338	$116,500		$4,000
DEVELOPMENT FEE	400,300					400,300			
OTHER FEES	0					0			
TOTAL DEVELOPMENT COSTS	$3,023,300			DEPRECIABLE BASE		263,153	ORGINAL ASSETS:		267,153
					REAL		199,518		75.82%
					PERSONAL		63,635		24.18%

$549,485 ** historic credit has been removed from depreciable base

Source: Boston Capital

Typical Low-Income Housing Tax Credit Pro Forma Analysis: Pricing

– PRICING –

OPERATING PARTNERSHIP	LIHTC APARTMENTS L.P.
GENERAL PARTNER	JOE Q. PUBLIC
# OF UNITS	64
FILE	R:\users\appmc\123\cdi0w\last_exp1
DATE	08-Jun-94

		LIHTC/ NEW CONSTRUCTION OR REHABILITAION			LIHTC/ ACQUISITION	HISTORIC REHABILITATION
Elig. Development Costs		$2,438,500			$66,000	$2,347,127
Less: Historic Credit		549,485				
Add: Developer's Fee		400,300	15.25%		0	400,300
Add: Other		0	0.00%		0	0
Eligible Basis		$2,289,315	15.25%	OF TDC'S	$66,000	$2,747,427
Percentage Low Income		130.00%			100.00%	100.00%
Qualified Basis		$2,976,109			$66,000	$2,747,427
Tax Credit Percentage		8.50%			3.70%	20.00%
Reserved Credit/Projected Credit		$252,969			$2,441	$549,485
% To Investment Partnership		99.00%			99.00%	99.00%
– Projected Annual Net Tax Credit		$250,440			$2,418	$543,991
CALCULATION OF PRICE TO GENERAL PARTNER						
Eligible Basis		$2,289,315			$66,000	$2,747,427
Percentage LITHC	130.00%	2,976,109			66,000	2,747,427
x available tax credit		8.50%			3.70%	20.00%
x number of years available		10			10	1
x percentage to ILP		99.00%			99.00%	99.00%
Total potential tax credits to ILP		$2,504,396			$24,176	$543,991
Less lost credits		0			0	0
Total credits to ILP		2,504,396			24,176	543,991
x price for LIHTC		0.530			0.530	0.800
Amount Payable to OLP		$1,775,300			$12,810	$435,190
Additional Capital Paid to OLP (= BCP Acquisition Fee (Max.))		$0				
TOTAL PAID TO OP		1,775,300				
FINANCING SHORTFALL		(1,375,000)				
DEVELOPMENT FEE*		400,300				
OTHER		0				
RETURN OF CAPITAL (SPECIAL DIST)*		$0				
DEVELOPER'S OVERHEAD (OTHER FEES)*		$0				

Source: Boston Capital

APPENDIX 12.

ALL CASH METHOD

Boston Capital Corporate Tax Credit Fund II

Investment Schedule

October 1, 1993 through December 31, 2008

The following investment schedule illustrates capital contributions, tax credits and cash distributions and is based upon the investment objectives of the Investment Partnership.

The numbers and results depicted below and in other sections of this material are for illustrative purposes only and should not be considered a projection, prediction or guarantee of actual results.

Investors admitted after October 31, 1993, pay a higher price per unit and will receive fewer benefits in 1993.

Year	Capital Contributions	Tax Credits	Tax Deductions	Tax Savings*	Cash Distributions	Total Benefits	Net Investment Annual	Net Investment Cumulative
1993	$740,000	$0	($3,000)	$1,200	$0	$1,200	$738,800	$738,000
1994		50,000	(40,000)	66,000	0	66,000	(66,000)	672,800
1995		100,000	(51,000)	120,400	0	120,400	(120,400)	552,400
1996		116,000	(55,000)	138,000	0	138,000	(138,000)	414,400
1997		116,000	(51,000)	136,400	0	136,400	(136,400)	278,000
1998		116,000	(50,000)	136,000	1,000	137,000	(137,000)	141,000
1999		116,000	(45,000)	134,000	2,000	136,000	(136,000)	5,000
2000		116,000	(41,000)	132,400	3,000	135,400	(135,400)	(130,400)
2001		116,000	(38,000)	131,200	4,000	135,200	(135,200)	(265,600)
2002		116,000	(34,000)	129,600	5,000	134,600	(134,600)	(400,200)
2003		116,000	(34,000)	129,600	6,000	135,600	(135,600)	(535,800)
2003		66,000	(36,000)	80,400	7,000	87,400	(87,400)	(623,200)
2005		16,000	(31,000)	28,400	8,000	36,400	(36,400)	(659,600)
2006			(24,000)	9,600	9,000	18,600	(18,600)	(678,200)
2007			(20,000)	8,000	10,000	18,000	(18,000)	(696,200)
2008			(21,000)	8,400	11,000	19,400	(19,400)	(715,600)
TOTAL	**$740,000**	**$1,160,000**	**($574,000)**	**$1,389,600**	**$66,000**	**$1,455,600**	**($715,600)**	**($715,600)**

Residual Assumptions

Scenario I

Sale	Return of Capital
Assumed Sales Proceeds	$1,000,000
Taxes Due on Sale	(367,775)
Net Proceeds	632,225
Calculation of Tax on Sale	
Assumed Sale Proceeds	1,000,000
Cash Distributions	66,000
Tax Deductions	574,000
Less Capital	(740,000)
Taxable Gain	900,000
Tax at 40%	360,000
Total Benefit	
Cumulative Total Benefit	1,455,600
Net Sale Proceeds	640,000
Total After Tax Benefit	$2,095,600

Scenario II

Sale	$1 over mortgage
Assumed Sales Proceeds	$0
Taxes Due on Sale	(32,225)
Net Proceeds	(32,2.25)
Calculation of Tax on Sale	
Assumed Sale Proceeds	0
Cash Distributions	66,000
Tax Deductions	574,000
Less Capital	(740,000)
Taxable Gain	(100,000)
Tax at 40%	(40,000)
Total Benefit	
Cumulative Total Benefit	1,455,600
Net Sale Proceeds	(40,000)
Total After Tax Benefit	$1,415,600

*"Tax savings" is the sum of the tax credits and the savings attributable to the Tax Deductions at a marginal state and federal tax rate equal to 40%

INSTALLMENT METHOD

Boston Capital Corporate Tax Credit Fund II

Investment Schedule

October 1, 1993 through December 31, 2008

The following investment schedule illustrates capital contributions, tax credits and cash distributions and is based upon the investment objectives of the Investment Partnership

The numbers and results depicted below and in other sections of this material are for illustrative purposes only and should not be considered a projection, prediction or guarantee of actual results

Investors admitted after October 31, 1993 will receive fewer benefits in 1993.

Year	Capital Contributions	Tax Credits	Tax Deductions	Tax Savings*	Cash Distributions	Total Benefits	Net Investment	
							Annual	Cumulative
1993	$5,000•	0	($18,000)	$7,200	$0	$7,200	($2,000)	($2,200)
1994	80,000	50,000	(97,000)	88,800	0	88,800	(8,800)	(11,000)
1995	110,000	100,000	(104,000)	141,600	0	141,600	(31,600)	(42,600)
1996	130,000	116,000	(101,000)	156,400	0	156,400	(26,400)	(69,000)
1997	155,000	116,000	(90,000)	152,000	0	152,000	3,000	(66,000)
1998	155,000	116,000	(79,000)	147,600	1,000	148,600	6,400	(59,600)
1999	175,000	116,000	(62,000)	140,900	2,000	142,800	32,200	(27,400)
2000	185,000	116,000	(45,000)	134,000	3,000	137,000	48,000	20,600
2001		116,000	(38,000)	131,200	4,000	135,200	(135,200)	(114,600)
2002		116,000	(34,000)	129,600	5,000	134,600	(134,600)	(249,200)
2003		116,000	(34,000)	129,600	6,000	135,600	(135,600)	(384,800)
2004		66,000	(36,000)	80,400	7,000	87,400	(87,400)	(472,200)
2005		16,000	(31,000)	28,400	8,000	36,400	(36,400)	(508,600)
2006		0	(24,000)	9,600	9,000	18,600	(18,600)	(527,200)
2007			(20,000)	8,000	10,000	18,000	(18,000)	(545,200)
2008			(21,000)	8,400	11,000	19,400	(19,400)	(564,600)
TOTAL	**$995,000**	**$1,160,000**	**($834,000)**	**$1,493,600**	**$66,000**	**$1,559,600**	**($564,600)**	**($564,600)**

Residual Assumptions

Scenario I

Sale	Return Of Capital	
Assumed Sales Proceeds		$1,000,000
Taxes Due on Sale		(362,000)
Net Proceeds		638,000
Calculation of Tax on Sale		
Assumed Sale Proceeds		1,000,000
Cash Distributions		66,000
Tax Deductions		834,000
Less Capital		(995,000)
Taxable Gain		905,000
Tax at 40%		362,000
Total Benefit		
Cumulative Total Benefit		1,559,600
Net Sale Proceeds		638,000
Total After Tax Benefit		$2,197,600

Scenario II

Sale	$1 over mortgage	
Assumed Sales Proceeds		$0
Taxes Due on Sale		38,000
Net Proceeds		38,000
Calculation of Tax on Sale		
Assumed Sale Proceeds		0
Cash Distributions		66,000
Tax Deductions		834,00
Less Capital		(995,000)
Taxable Gain		(95,000)
Tax at 40%		(38,000)
Total Benefit		
Cumulative Total Benefit		1,559,600
Net Sale Proceeds		38,000
Total After Tax Benefit		$1,597,600

*"Tax savings" is the sum of the tax credits and the savings attributable to the Tax Deductions at a marginal state and federal tax rate equal to 40%

•Capital investment is reduced by .5% Credit Discount

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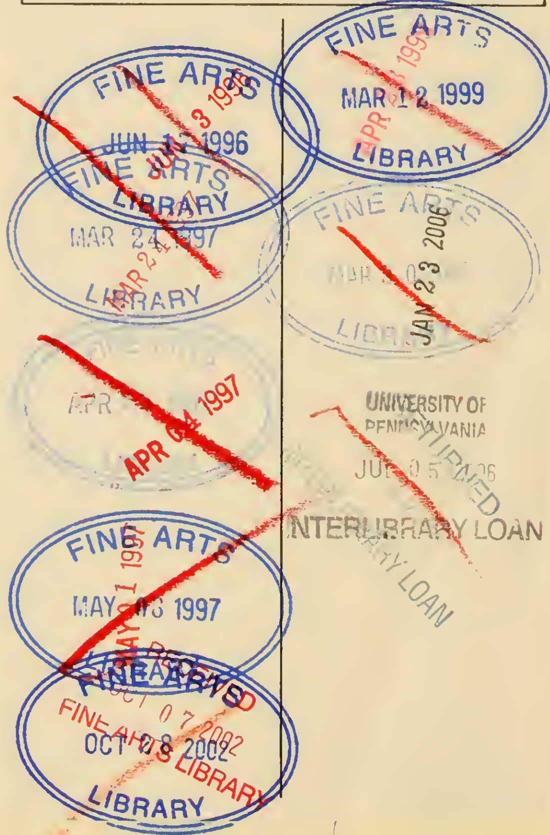

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