



**Comptroller of the Currency  
Administrator of National Banks**

# **Low-Income Housing Tax Credit Funds: Investment Opportunities for Banks**

A Web and Telephone Seminar

**Wednesday, September 10, 2008**

**2:00 pm – 3:30 pm Eastern**

**1:00 pm – 2:30 pm Central**

**12:00 pm – 1:30 pm Mountain**

**11:00 am – 12:30 pm Pacific**

**Presented by:**

**Dana S. Boole**

**Richard A. Floreani**

**Barry Wides**



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## *Presented by:*

- Barry Wides, Moderator  
OCC
- Dana Boole, Presenter  
CAHEC
- Richard A. Floreani, Presenter  
Ernst & Young





## *Speaker Biographies*

*Welcome by John C. Dugan*

*Open Remarks by Barry Wides*

*Power Point Presentation*

*Questions and Answers*



# John C. Dugan



**John C. Dugan**  
*Comptroller of the Currency*  
OCC

John C. Dugan was sworn in as the 29th Comptroller of the Currency on August 14, 2005.

The Comptroller of the Currency is the administrator of national banks and chief officer of the Office of the Comptroller of the Currency (OCC). The OCC supervises 1,900 federally chartered commercial banks and about 50 federal branches and agencies of foreign banks in the United States, comprising more than half the assets of the commercial banking system. The Comptroller also serves as a director of the Federal Deposit Insurance Corporation, the Federal Financial Institutions Examination Council, and the Neighborhood Reinvestment Corporation.

Prior to his appointment as Comptroller, Mr. Dugan was a partner at the law firm of Covington & Burling, where he chaired the firm's Financial Institutions Group. He specialized in banking and financial institution regulation. He also served as outside counsel to the ABA Securities Association.

He served at the Department of Treasury from 1989 to 1993 and was appointed assistant secretary for domestic finance in 1992. While at Treasury, Mr. Dugan had extensive responsibility for policy initiatives involving banks and financial institutions, including the savings and loan cleanup, Glass-Steagall and banking reform, and regulation of government-sponsored enterprises. In 1991, he oversaw a comprehensive study of the banking industry that formed the basis for the financial modernization legislation proposed by the administration of the first President Bush.



# John C. Dugan



From 1985 to 1989, Mr. Dugan was minority counsel and minority general counsel for the U.S. Senate Committee on Banking, Housing, and Urban Affairs. There he advised the committee as it debated that Competitive Equality Banking Act of 1987, the Proxmire Financial Modernization Act of 1988, and the Financial Institutions Reform, Recovery, and Enforcement Act of 1989.

Among his professional and volunteer activities before becoming Comptroller, he served as a director of Minbanc, a charitable organization whose mission is to enhance professional and educational opportunities for minorities in the banking industry. He was also a member of the American Bar Association's committee on banking law, the Federal Bar Association's section of financial institutions and the economy, and the District of Columbia Bar Association's section of corporations, finance, and securities laws.

A graduate of the University of Michigan in 1977 with an A.B. in English literature, Mr. Dugan also earned his J.D. from Harvard Law School in 1981. Born in Washington, DC in 1955, Mr. Dugan lives in Chevy Chase, MD, with his wife, Beth, and his two children, Claire and Jack.



# Barry Wides



## **Barry Wides**

*Deputy Comptroller  
OCC Community Affairs*

Barry Wides is the OCC's Deputy Comptroller for Community Affairs, in which capacity he leads a department of community development professionals located in Washington, D.C., and the four OCC districts. The Community Affairs staff is responsible for outreach to banks and their community partners, the administration of the "Part 24" public welfare investment authority, the development of policy, and the creation and distribution of educational materials on community development issues.

Prior to joining the OCC in 1999, Mr. Wides was Director of Affordable Housing Sales at Freddie Mac. He led a nationwide sales team responsible for developing products and strategies to achieve the company's congressionally mandated affordable housing goals. He previously served as Deputy Director of the Resolution Trust Corporation's Affordable Housing Program. Mr. Wides began his career in Washington as a presidential management intern and budget examiner at the Office of Management and Budget.

Barry is a Certified Public Accountant and holds a B.S. in accounting and an M.B.A. from Indiana.



# Dana Boole



**Dana Boole**

*President and CEO*

*Community Affordable Housing Equity Corporation*

*Raleigh, North Carolina*

Dana Boole is the President and CEO of Community Affordable Housing Equity Corporation (CAHEC). He has been with CAHEC since 2001. His duties include the management of CAHEC's operations and oversight of its fund raising efforts throughout the United States with primary focus in the mid-Atlantic and southeastern states. His management responsibilities include (1) guiding CAHEC's overall strategy and operations; (2) accountability for CAHEC's growth, furtherance of its mission, and oversight of its financial condition; and (3) provision of the leadership, vision, and resources necessary to maintain the company's strategic competitive advantage. Fund-raising responsibilities include (1) managing the company's activities for federal, state, and historic tax credit funds; (2) diversifying efforts to include multi-investor, private label, and historic-only funds; and (3) sourcing investors through a combination of direct originations and broker relationships.

Mr. Boole came to CAHEC from Edison Capital Housing Investments in Boston. As Acquisitions Director at Edison, he focused primarily on equity syndication in the eastern United States. Before joining Edison, he held positions as Vice President of Acquisitions for National Partnership Investments Corp. and as a commercial real estate consultant for the Leggat Company.

Mr. Boole received his bachelor of arts in economics from the University of Vermont and his MBA in finance and strategy from the F.W. Olin School of Business at Babson College. Mr. Boole currently serves as a Class B Director for the Federal Reserve Bank of Richmond and is a standing member of its Planning and Operations Committee and Audit Committee.





# Richard Floreani



**Richard A. Floreani**  
*Senior Manager*  
*Tax Credit Investment Advisory Services*  
*Ernst & Young*

Richard A. Floreani is Senior Manager for the Tax Credit Investment Advisory Services group at the accounting firm of Ernst & Young. In that position, he advises institutional clients on risk analysis and investment evaluation in a majority of housing credit investment funds syndicated. He has 17 years of experience counseling clients on tax credit transactions. Since joining Ernst & Young in 1996, he has focused on representing institutional investors in transactions that earn them tax credits for investing in low-income housing, historic rehabilitation, community development (“new markets”), and renewable energy.

Mr. Floreani also advises banking and insurance clients on regulatory matters relating to tax credit investments and tax policy evaluation. He also helps investors and tax credit syndicators benchmark performance and improve operational efficiency. In addition, he produces Understanding the Dynamics, the industry’s annual survey of housing tax credit investment and property performance.

Prior to joining Ernst & Young, Mr. Floreani was employed at Affirmative Investments, Inc., a development and financial consulting firm specializing in housing tax credit transactions. During his tenure, he prepared financial projections, conducted real estate due diligence, structured legal and tax issues, and negotiated financing terms on behalf of affordable housing developers.

Mr. Floreani graduated with a B.A. degree (cum laude) from Boston University and currently serves on the board of directors of AIDS Housing Corporation.



# Welcome



John C. Dugan

*Comptroller of the Currency*



# Opening Remarks



Barry Wides

*Deputy Comptroller*

*OCC Community Affairs*



# Topics To Be Covered



**Dana Boole**  
**President and CEO**  
*Community Affordable Housing  
Equity Corporation*  
*Raleigh, North Carolina*

- How do tax credits differ from tax deductions?
- Why invest in housing tax credits?
- Who invests in housing tax credits?
- What are the methods of fund investing?
- What are the primary benefits of fund investing?
- CAHEC Funds and Portfolio
- How does a bank evaluate a fund manager and fund?
- How are housing tax credits calculated?
- What are the underwriting and pricing considerations?



# What Is a Credit versus a Deduction?



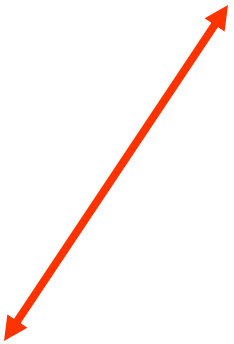
- \$1 of credit reduces \$1 of taxes owed by \$1
- \$1 of deduction reduces \$1 of taxes owed by the applicable tax rate (i.e. 35%)





# Example of Credit versus Deduction

	<u>Credit</u>	<u>Deduction</u>
Gross Income	\$1,000,000	\$1,000,000
Less Deduction		(\$100,000)
Adjusted Income	\$1,000,000	\$900,000
Taxes @ 35%	\$350,000	\$315,000
Less Housing Credits	(\$100,000)	
Taxes Owed	\$250,000	\$315,000

A red arrow points from the "Less Housing Credits" row in the "Credit" column to the "Less Deduction" row in the "Deduction" column, highlighting the difference in tax treatment between the two.



# Why Invest in Housing Credits?

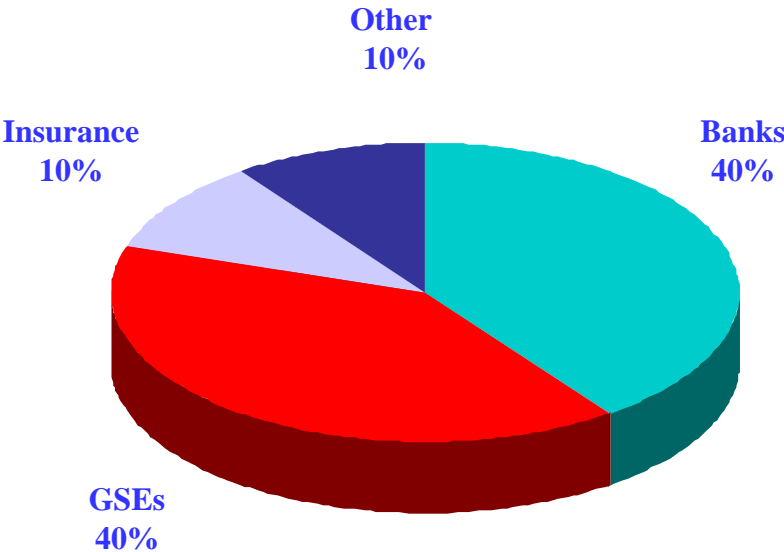
- Increases after tax earnings
- Provides financial return on investment (credits and operating losses)
- Provides financial performance similar to bond instruments
- Receives consideration under the Investment Test of the CRA
- Provides safe and affordable housing to residents
- Provides community banks with an additional vehicle for their investment strategy



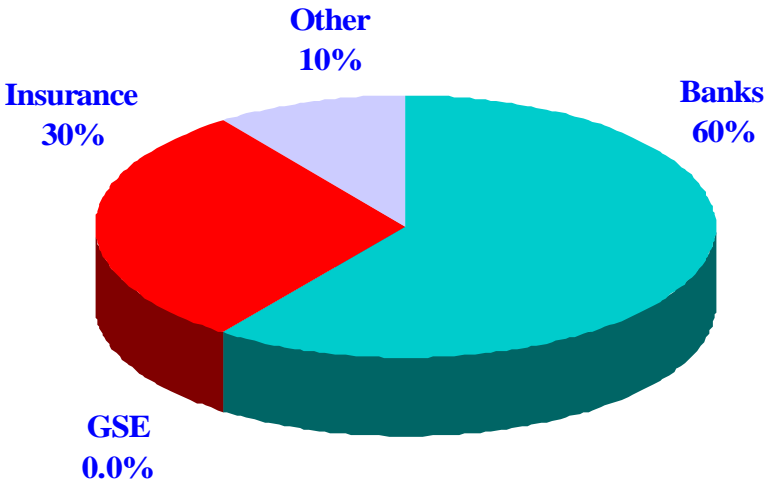


# Who Invests in Housing Credits?

2007  
(~ \$9 Billion Market)



Projected 2008  
(~ \$5 Billion Market)





# Methods to Fund Investing



*Fund-Type*

	National	Regional	State-Specific
<i>Investment-Type</i> Multi			
Private Label			



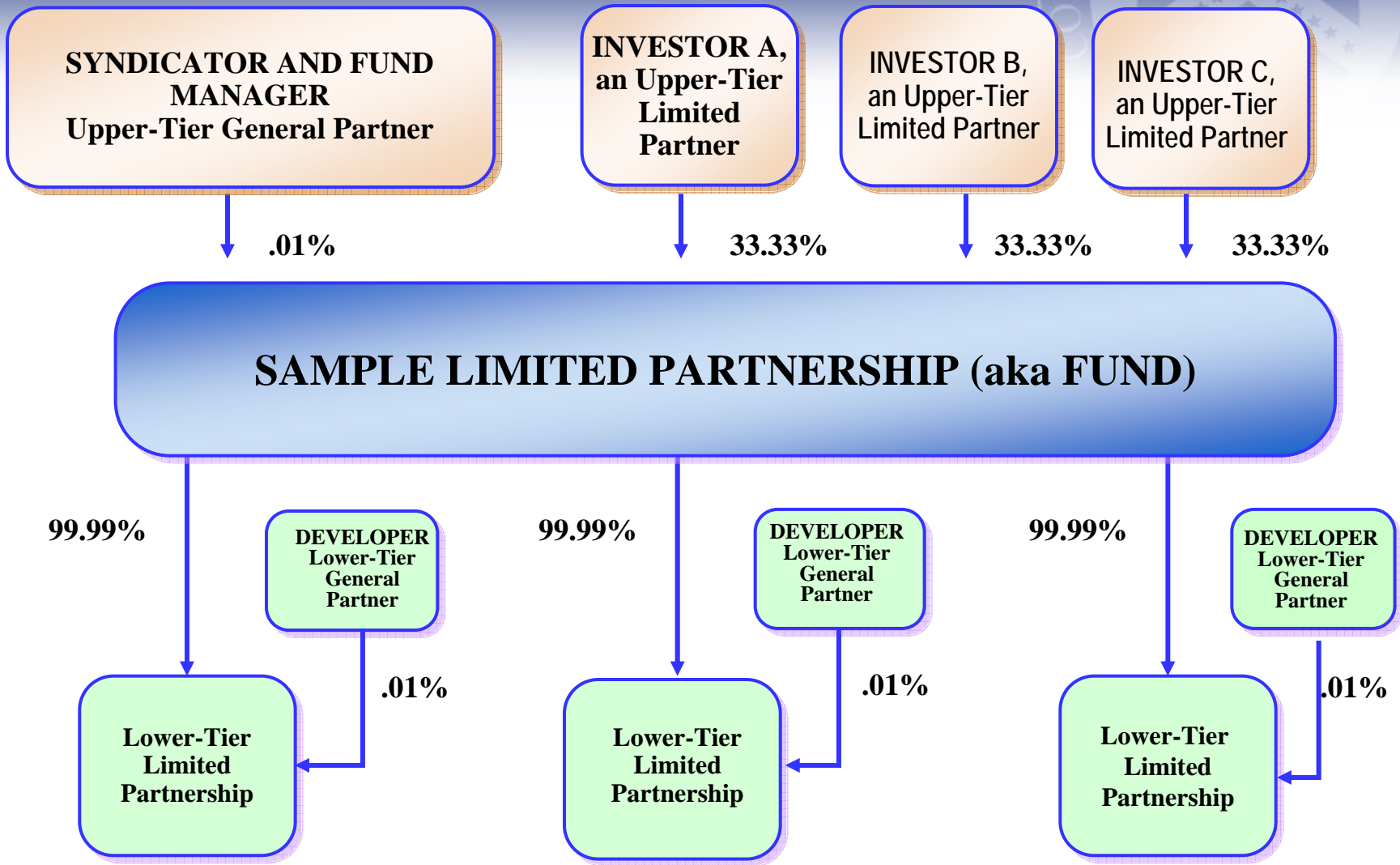
# Primary Benefits of Fund Investing



- **Risk Sharing and Diversification** – investments often extend over many properties and states
- **CRA Consideration** – investments may be targeted for specific regions, states, and in some instances, counties
- **Underwriting Expertise** – fund managers select projects for inclusion in funds after meeting strict criteria for market, financial and tax guidelines
- **Asset and Compliance Management Expertise** – fund managers are well versed in Section 42 and applicable housing law
- **Flexible Investment Amounts** – can invest as little as \$500,000



# Sample Fund Structure



## CAHEC's CEF XIII (6/30/08)



- Raised \$95 million (10 investors)
- Invested in 24 assets (~ 1,300 residential units)
- Invested in seven mid-Atlantic and southeast states
- 25% of assets had state credits
- 50% of assets were new construction (balance were rehabilitations)
- 25% of assets were family developments (balance were elderly)



# CAHEC's Portfolio (6/30/08)



- 22 LIHTC and 11 historic tax credit funds
- Seven states
- 205 assets
- 9,017 residential and 58 commercial units
- \$675,000,000 subscribed and under management
- No incidence of recapture or foreclosure



# Evaluating a Fund Manager



- **Financial Condition** – strength of balance sheet to maintain longevity during lean economic conditions
- **Business Strategy** – sound core competencies and business direction that lead to a sustainable competitive advantage
- **Employees** – seasoned staff, low attrition and sound leadership
- **Acquisitions and Underwriting** – guidelines that are consistent with current industry standards
- **Asset Management** – ability to monitor ongoing compliance and provide investment data using industry accepted performance criteria



# Evaluating a Fund Manager (continued)



- **Risk Management** – proven ability to manage and mitigate problem properties
- **Investor Reporting** – consistency in meeting financial deadlines (audit and tax returns) of corporate investors
- **Geographic Knowledge** – breadth and depth of portfolio from a diverse economic base
- **Portfolio Performance** – ability to meet target yields and benefits
- **Investor Base** – proven ability to grow and diversify sources of capital which allows a fund to hedge against sector downturns



# Evaluating a Fund

- **CRA** – affirm (through your regulator) that the fund’s target investments will satisfy the needs of your next CRA examination under the Investment Test
- **Properties** – undertake due diligence of the fund, the syndicator, and the properties being acquired through internal resources or third parties
- **Accounting** – secure approval from internal accounting and external auditors as to the non-CRA impact of the investment on your financials





## Evaluating a Fund (continued)



- **Tax** – ensure that your expected tax liability is sufficient to make use of the tax benefits (now can be used against the Alternative Minimum Tax (AMT)), carry backs and carry forwards permitted
- **Investor Profile** – determine the fund manager’s track record in working with (past and current funds) investors whose size and needs align with yours
- **References** – identify institutions (similar to your size and geographic needs) that have previously worked with the fund manager and learn about the institutions’ past experiences



# How Is the Amount of a Project's Housing Credit Calculated?



Units	50	Multiplied by Tax Credit Rate	9.00%
Multiplied by Unit Cost (including Land)	\$80,000	Annual Allocation	\$315,000
<i>Total Cost</i>	\$4,000,000	Multiplied by	10 years
Land Cost	(\$400,000)	Available Credits	\$3,150,000
Non-Depreciable Expenses	(\$100,000)	Multiplied by Credit Price	\$0.83
<i>Depreciable Basis</i>	\$3,500,000	Available Equity	\$2,614,500



# What Are a Project's Underwriting Considerations?



- Past performance of development team - collectively and independently
- Financial projections - project and fund level
- Real estate and tax due diligence
- Site and operational considerations
- Project comparables - market and affordable



# What Are a Project's Pricing Considerations?



- Timing of the equity investment (pay-in schedule) and the delivery of benefits (credits and tax savings) to the investor
- Desirability of property for CRA purposes
- Strength of development team and guarantors
- Strength of market, including net demand from income qualified households and likely achievable rents given income restrictions and asking rents at competing properties
- Alignment of project yield versus fund target





# Simplified Investor Benefits Projection

<u>Year</u>	<u>Capital Contributed</u>	<u>Tax Credits Earned</u>	<u>Tax Deductions Earned (at 35% tax rate)</u>
2008	\$200,000	\$0	\$12,000
2009	\$300,000	\$0	\$18,000
2010	\$500,000	\$110,000	\$33,000
2011-2019	\$0	\$110,000 (annually)	\$27,000 (annually, on average)
2020-2024	\$0	\$0	\$22,000 (annually, on average)
<b>Total</b>	<b>\$1,000,000</b>	<b>\$1,100,000</b>	<b>\$350,000</b>

*\$1 million investment earns investor \$1.45 million in total benefits and yields a 7% IRR*



# Topics To Be Covered

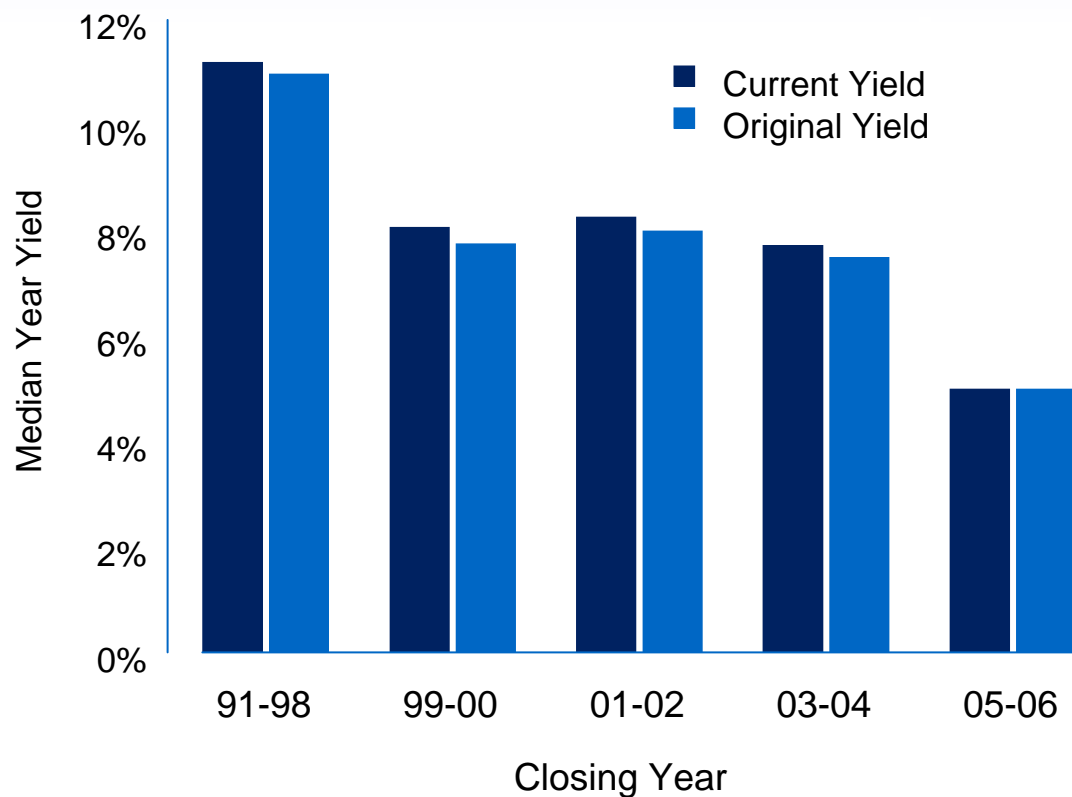


**Richard A. Floreani**  
*Senior Manager*  
*Tax Credit Investment*  
*Advisory Services*  
*Ernst & Young*

- How have these investments performed?
- What are current market conditions and yields?
- Does subprime have any effect on these investments?
- What is happening on the legislative front?



# Yield (Internal Rate of Return) History



- Understanding the Dynamics: largest survey of housing tax credit performance – over 15,000 properties, 1.2 million units, and \$43.6 billion of equity investment
- Download for free at: [www.ey.com/us/taxcreditadvisory](http://www.ey.com/us/taxcreditadvisory)
- Most investments provide returns at or above originally projected levels
- Trend holds independent of investment age



# Beyond Yield



- Favorable return performance isn't the whole story – the constituents of yield also warrant examination
- Overall credits realized over the life of the investment are very close to original projections
- Tax credits realized in the first few years are frequently delayed
- Tax deductions are frequently higher than projected
- Tax credit delays are offset by the higher tax deductions **and** by delaying capital calls on investors, thus preserving yield realization
- Housing tax credits may be carried back one year or carried forward up to 20 years if not used in the year received
- Examining the economic performance of properties is critical, since they must avoid foreclosure over the life of the investment

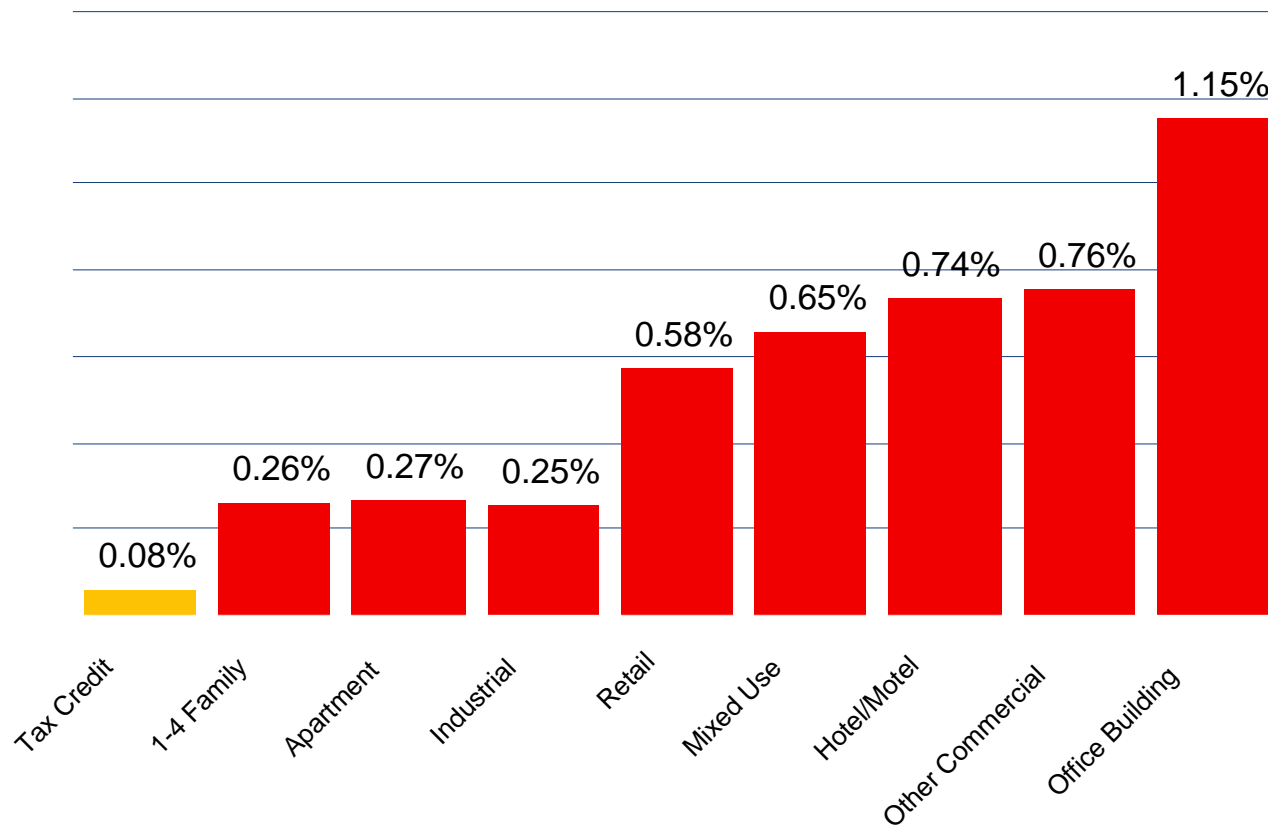




# Industry Performance



Average Annual Foreclosure Rate by Asset Class: 1993 - 2006



Source: ACLI Mortgage Loan Portfolio Profile, 1993-2006 Except Tax Credit Data



# Property Performance



	<b>Median Performance 2006</b>	<b>Standard Tax Credit Underwriting</b>
<b>Physical Occupancy</b>	96.2%	93-95%
<b>Hard Debt Coverage Ratio</b>	1.14	1.15
<b>Cash Flow Per Unit</b>	\$247	\$250

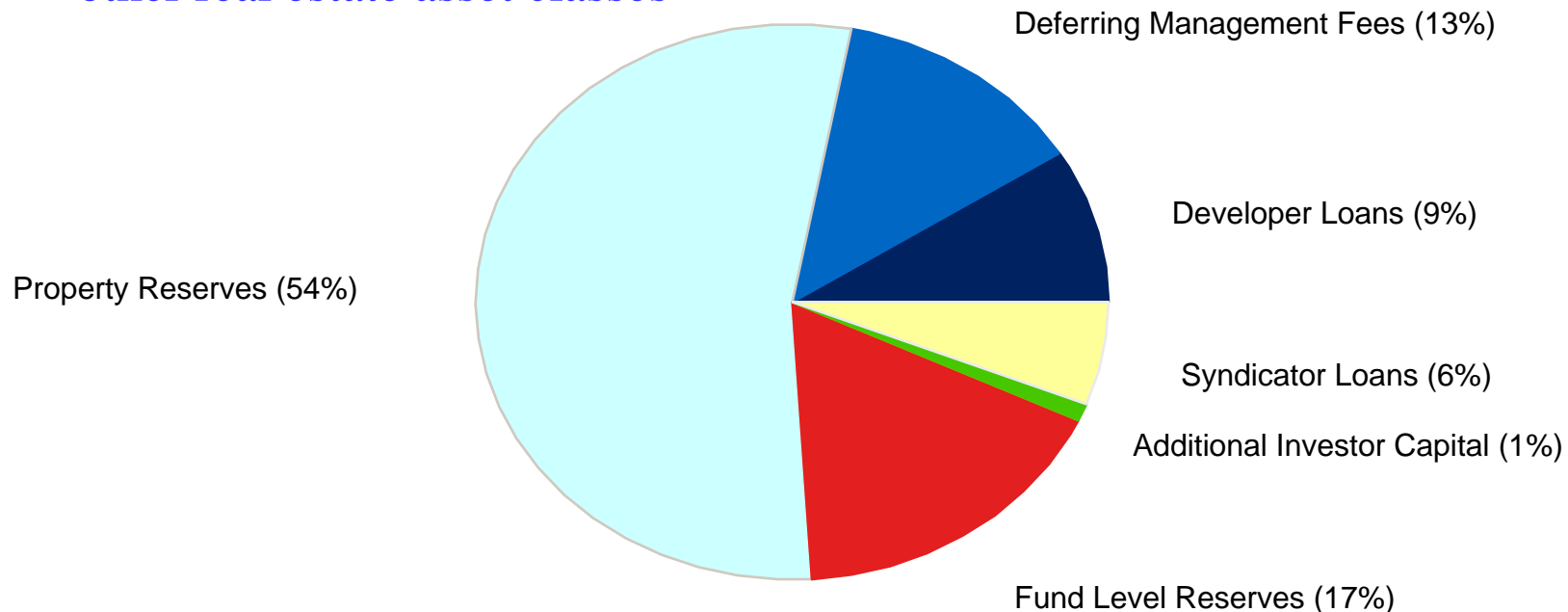
- Low operating margin among properties makes affordable housing different from conventional real estate - 15% cushion
- Objective is delivering tax benefits, not maximizing cash flow
- Results in more properties with operating deficits, though most short-term or small in amount



# How Are Cash Flow Problems Addressed?



- For those properties that do have deficits, risk offset by requiring operating reserves, developer guarantees, management fee deferral provisions, and other structures to help insulate investors from risk
- These deficit funding sources help keep the foreclosure rate lower than the other real estate asset classes



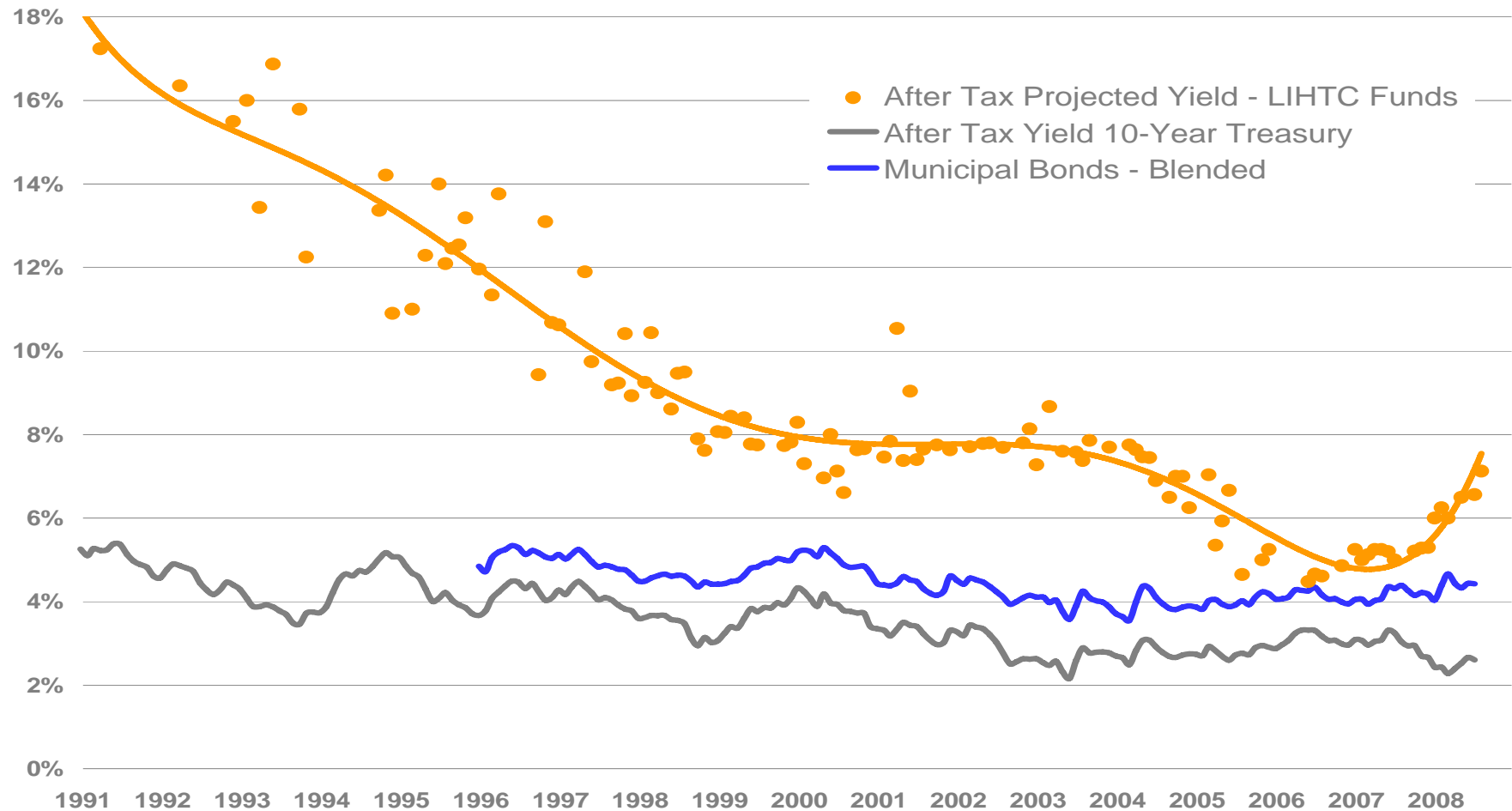
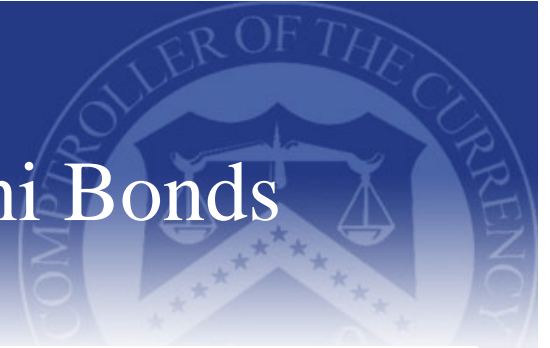


# Current Market Conditions

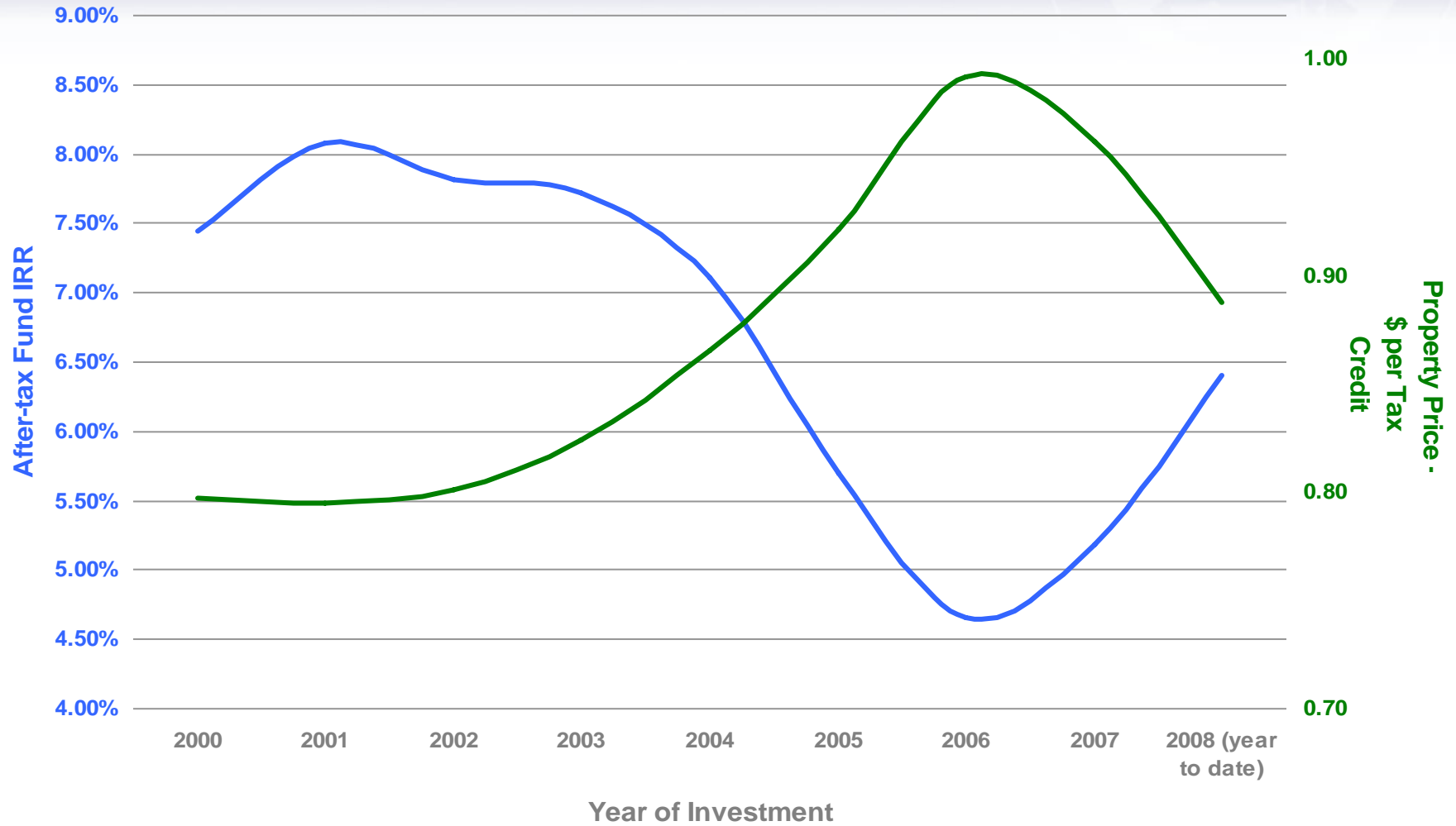
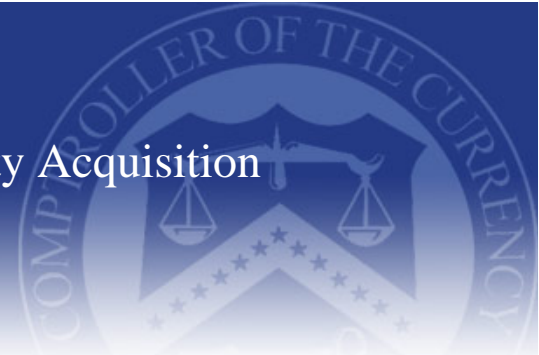
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# After-Tax Yield Trends: Tax Credits, 10-Year Treasuries, Muni Bonds



# Housing Tax Credit Yields and Pricing: Median After-tax Fund Internal Rate of Return vs. Property Acquisition Prices in Dollars per Dollar of Tax Credit



# Current Conditions and Opportunities



- Pricing and yields changed quickly and dramatically at the end of 2007 due to pullback from lead investors facing AMT, capital constraints, and other financial issues unrelated to housing credit investments
- Rising yields and more negotiating opportunity are enticing new investors (and sidelined investors) into the market
- Some syndicators are facing significant issues and are downsizing, others are seeing growth opportunities
- Syndicators are more willing to be flexible and work with smaller investors in this environment



# Legislative Changes



## Housing and Economic Recovery Act of 2008, H.R. 3221

- Signed into law July 30, 2008 and contains many provisions to improve the housing tax credit program:
  - ◆ Allows use of housing tax credit against the (AMT) to help broaden the base of investors (for buildings placed in service after 12/31/07)
  - ◆ Eliminates recapture bond requirements to help increase the liquidity of investments by reducing the cost and administrative burden of reselling
  - ◆ Provides more flexibility to state allocators in determining which developments to target and how much subsidy the developments receive
  - ◆ Temporarily increases amount of credits available (2008-09)
  - ◆ Provides many other technical fixes to streamline transactions and clarify industry questions







**Barry Wides**  
*Deputy Comptroller*  
*OCC Community Affairs*

## Regulatory Considerations: CRA and Part 24



# Regulatory Considerations: CRA



- Affordable housing is a fundamental element under CRA
- CRA consideration for investments in LIHTC funds creating affordable housing
- An investment in a LIHTC fund:
  - ◆ Receives positive CRA consideration, provided it benefits:
    - ◆ The bank's assessment area
    - OR
    - ◆ The broader statewide or regional area that includes the bank's assessment area



# Regulatory Considerations: Part 24



- National banks can make investments to promote the public welfare
- Affordable housing promotes the public welfare
- Investment authority is under 12 USC 24 (Eleventh) and 12 CFR Part 24
- Part 24 authority limits were recently raised to 15 percent of a bank's unimpaired capital and surplus
- Banks make investments through a filing process with the OCC (See [www.occ.gov/cdd/pt24toppage.htm](http://www.occ.gov/cdd/pt24toppage.htm))





## How Does an Investor Become Involved with Housing Credits?



# How To Get Involved



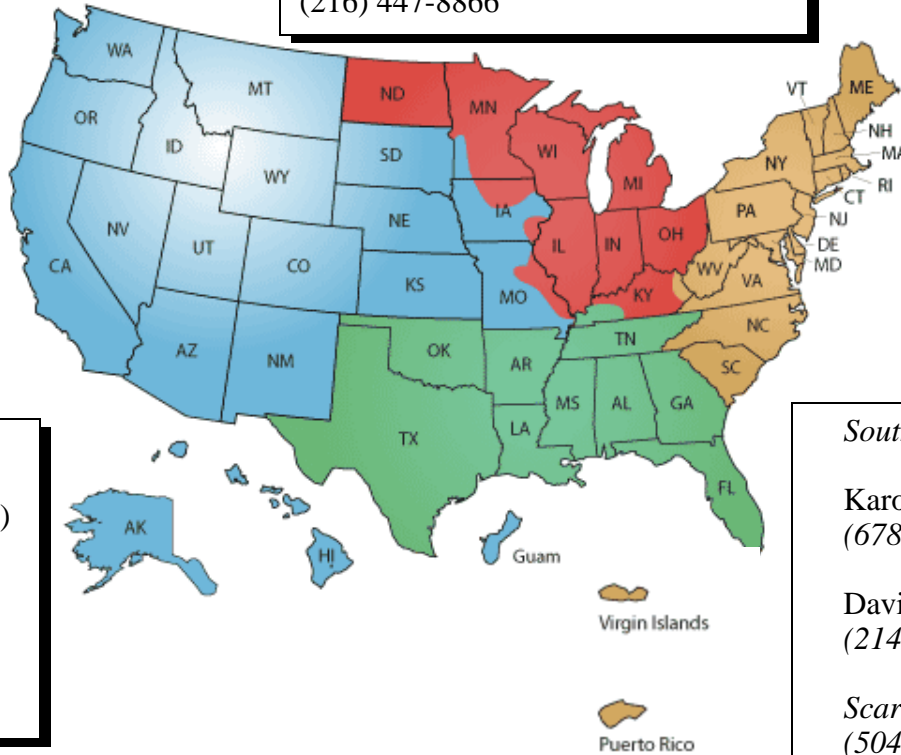
- Communicate with peer banks about their experiences in the tax credit program
- Communicate with OCC District Community Affairs Officers  
<http://www.occ.treas.gov/cdd/commfoc.htm>
- Communicate with your local bankers association
- Industry Web sites
  - ◆ <http://www.naslef.org>
  - ◆ <http://www.ncsha.org>
  - ◆ <http://www.ahic.org>



# Community Affairs Field Locations



- Central District
- Northeastern District
- Southern District
- Western District



*Central*

Paul Ginger (*Chicago*)  
(312) 860-8876

Norma Polanco-Boyd (*Cleveland*)  
(216) 447-8866

*Northeastern*

Bonita Irving (*Boston*)  
(617) 854-6547

Denise Kirk-Murray (*New York*)  
(212) 790-4053

Vonda Eanes (*Charlotte*)  
(704) 554-7082

*Western*

Susan Howard (*Glendale, CA*)  
(818) 240-5175

Dave Miller (*Denver*)  
(720) 475-7670

*Southern*

Karol Klim (*Atlanta*)  
(678) 731-9723 x252

David Lewis (*Dallas*)  
(214) 720-7027

Scarlett Duplechain (*New Orleans*)  
(504) 828-6555



# Other Resources



## Office of the Comptroller of the Currency

- *Community Developments Insights*  
“Low-Income Housing Tax Credits: Affordable Housing Investment Opportunities for Banks”  
<http://www.occ.treas.gov/ftp/release/2008-10a.pdf>
- *Community Developments Investments E-zine*  
“Investing in Low-Income Housing Tax Credits: A Sound Opportunity for Community Banks”  
<http://www.occ.treas.gov/cdd/Spring06>
- *Low-Income Housing Tax Credits Fact Sheet*  
[http://www.occ.treas.gov/cdd/fact\\_sheet\\_LIHTC.pdf](http://www.occ.treas.gov/cdd/fact_sheet_LIHTC.pdf)
- Part 24 Community Development Investments  
<http://www.occ.gov/cdd/pt24toppage.htm#OCCsPt24Resources>



# Questions





# Questions and Answers



Push \*1 on your telephone key pad to comment or ask your question

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Send your comment/question by clicking on the “question icon” in the lower right corner of your screen. Type your question or comment in the window that appears, and click “send.”

**Submitted questions will be answered as time allows**



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# Evaluation Form



- Please complete the evaluation form online,  
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# Office of the Comptroller of the Currency

## Low-Income Housing Tax Credit Funds: Investment Opportunities for Banks

September 10, 2008

If you prefer to submit your evaluation online, please go to: <http://eval.krm.com/eval.asp?id=14103>

**SCALE:**    1 - Excellent    2 - Good    3 - Fair    4 - Poor

**1    2    3    4**

- 1. Overall rating .....
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- 3. Audio quality of seminar .....

**Presenter: Overall Effectiveness**

- 4. Dana Boole .....
- 5. Richard Floreani .....
- 6. Barry Wides .....

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What topics would you like OCC to address during the next 12 months?

PLEASE KEEP WRITTEN COMMENTS WITHIN BOX

Name (optional): \_\_\_\_\_