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Unlocking Tax-Credit Opportunities

State and federal programs may open doors for deals that wouldn't be done otherwise

COMMERCIAL MORTGAGE BROKERS OFTEN work with deals that are challenging to finance for any number of reasons. It is their responsibility, however, to ensure that the deal doesn't fall through because of an underwriting issue — like loan-to-value considerations that reduce the size of the mortgage a lender will approve.

One way for knowledgeable commercial mortgage brokers to improve the borrower's position in lenders' eyes is to consider the potential advantages of various tax-credit programs. There are several different state and federal tax credits that could tip the balance in favor of a borrower who is short on equity. These credits also may make the overall economics of the project more attractive. For example, an eligible borrower who initially required $10 million in financing may need only $7 million after tax-credit considerations. This can make the loan approval smoother, while also decreasing the debt burden for the borrower.

Understanding how tax credits can open doors to securing financing for deals that may not have been done otherwise is critical to commercial mortgage brokers' ability to develop new business and widen their client base. Here are five of the most common tax credits currently available.

Illustration: Dennis Wunsch

New markets tax credits

In an effort to spur investment in low-income communities, the new markets tax credits (NMTC) program was created by the Community Renewal Tax Relief Act of 2000. The original allocation authority eligible for the NMTC program was a total of $15 billion from 2001 to 2007. Congress subsequently increased the total allocation to $33 billion and extended the program to 2011. The American Taxpayer Relief Act of 2012 included an extension of the NMTC program for 2012 and 2013, with an allocation authority of $3.5 billion for each year.

To take advantage of this program, loans and capital investments must be made to businesses in specifically designated qualified low-income communities. This designation is important because the communities are not necessarily economically distressed, but they can be areas where the median income meets a certain threshold.

In this scenario, a borrower who holds an equity investment in a qualified-community-development entity may be entitled to a new-markets tax credit of 39 percent of the qualified investment in a seven-year credit period. Because NMTC allocations are limited, they are approved through a competitive process, which is set up so that the most qualified organizations receive first consideration.

Low-income housing tax credits

Low-income housing tax credits (LIHTC), created by Congress to generate equity

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capital for the construction and rehabilitation of affordable rental housing, can be an incentive and a solution for commercial property developers who may have minor funding issues. The use of these tax credits is possible if multifamily owners or developers agree to lease to people meeting a certain income threshold that is set based on the U.S. Department of Housing and Urban Development's determined area median income, and they agree to the recording of a use restriction on the property.

These credits offset federal taxes on a dollar-for-dollar basis for a 10-year period and are awarded by state housing departments. When developers use LIHTC, they can sell the tax credits at a discount directly to investors or to a syndicator to raise the project's equity. As a result, developers will have to contribute less equity or possibly no equity at all. In return for the tax-credit designation, the property must remain affordable to low-income individuals for at least 15 years through restrictions on rents to below-market rates.

Historic-rehabilitation tax credits

Historic-rehabilitation tax-credit programs are among the nation's most cost-effective community-revitalization programs. The rehabilitation of a historic property often is not the most desirable strategy to pursue because developers may be wary of the many restrictions involved in renovating the property.

The decision to proceed with the purchase of a historic building can have special appeal, however, as rehabilitation may serve as a way to demonstrate commitment to the greater community. Alternatively, circumstances could require choosing a building in an already designated historic area. The previous use of the building, especially if unusual in nature, also may weigh in on the selection of a specific building.

Working with buildings in need of historic rehabilitation may help ease the burden of financing. With still stringent lending requirements in today's market, securing the needed amount of financing to build a new structure or to buy an already constructed building can be challenging. Historic-rehabilitation tax credits can ease this challenge and even may result in a more favorable financing solution. By some estimates, state and federal credits combined can offset as much as 45 percent of a construction project's budget, virtually making or breaking the feasibility of resurrecting a building of significant community value.

In addition to augmenting urban renewal, the outcomes of these credits can help finance a project that might not otherwise get the go-ahead, creating new construction jobs for the area. Being designated as a historic property also may increase property values, enhancing the overall economic bottom line.

Brownfields tax credits

Although some commercial property developers try to avoid brownfields sites, others recognize the benefits inherent in developing such a site, including qualifying for brownfields tax credits. This tax credit is meant to encourage the reclamation of polluted property. It also enhances the local — and the greater — economy by rehabilitating abandoned properties, which in turn creates jobs and generates property, excise and income taxes. These credits, however, are dependent on the type and location of the property considered.

In Massachusetts, for example, the Brownfields Tax Credit program allows as much as 50 percent of the eligible costs associated with cleaning up a brownfields site to be recouped by the owner in the form of a tax credit, and this reimbursement can be used toward future years' taxes or can be sold for a cash reserve. The program is set to expire this year, however.

According to this program, all environmental clean-up costs of a qualifying property will apply toward the issuance of brownfields tax credits. These costs include money spent to determine, contain, or remove contamination, and can incorporate engineering fees, laboratory testing and analysis costs, legal fees, and other agency fees. Like other tax credits, this type of tax credit can help borrowers complete a purchase that otherwise may not have been economically feasible.

Commercial mortgage brokers working with a brownfield-development deal should investigate whether similar tax-credit programs or other incentives are available in their area.

Renewable-energy credits

Unlike many other tax-credit programs, renewable-energy credits depend on the actions of the potential buyer as opposed to already-existing conditions like community economic levels, historic designations or contamination. In fact, two types of tax credits are associated with renewable energy:

1. **Renewable-energy tax credits** that are awarded based on the production of renewable energy
2. **Investment tax credits** that result from investing in the technology and infrastructure that create renewable energy

Renewable-energy credits impact the economy by creating jobs in renewable-energy exploration and encouraging investment in socially responsible forms of energy production. For each megawatt hour of electricity a renewable- energy project produces, the owner generates one renewable-energy credit. These credits then can be sold, allowing the producer of the renewable energy to reap revenue from the credit.

Unlike renewable-energy credits that are based on production, the federal investment tax credit is a capital-investment credit, earned when renewable-energy equipment is put into service, and amounts to a reimbursement of nearly 30 percent of the cost of the construction. Initial investments in renewable-energy products are offset by this credit, and the development and application of more capital-intensive renewable-energy technologies may make sense, at least from a financial standpoint.

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Commercial mortgage brokers who strive to find creative ways to develop their business and make their deals more attractive should familiarize themselves with the various types of tax credits available. Determining which tax credits a potential buyer may be eligible for is knowledge that could tip the balance toward securing financing for a challenging deal — and securing the approval of clients. ●