APPENDIX H

Overview of the 2013 North Carolina State Low-Income Housing Tax Credit Program

Fundamental Change

The North Carolina state low-income housing tax credit ("STC") is different from the federal tax credit ("LIHTC") and the state tax credit in effect prior to 2003 in that it is not an investment. There is no "sale" of the credit, no limited partner equity, or any of the other features of a tax-shelter investment. The program is administered by the NC Housing Finance Agency ("Agency") in conjunction with the NC Department of Revenue ("DOR"). Only developments with a 2013 LIHTC award are eligible. Projects using tax-exempt bond financing are ineligible.

Ownership Entities

The federal LIHTC flows from qualified low-income building(s) to the owner, which is either a limited liability company or limited partnership ("LLC/LP"). These entities are owned by members or partners (respectively). LLC/LPs are known as "pass-throughs" because all federal and state income tax events (such as profits, losses and credits) pass through to the members or partners. The LLC/LP essentially does not exist from an income tax perspective. Rather, the members/partners receive the LIHTC, and in exchange for the right to offset tax liability will invest equity.

The STC does not operate in the same manner. Under the state statute no STC flows from the LLC/LP to its members/partners. In every case the credit is either:

- claimed directly by the pass-through entity or
- transferred to the Agency.

The first of these is commonly referred to as the "direct refund" or "grant" option, and the latter as the "Agency loan" option.

Calculation of STC Amount

The STC amount is equal to 10%, 20% or 30% of the development's qualified basis, which is the total cost to construct the buildings less 1) items not subject to depreciation (such as land and reserves) and 2) the cost of market-rate units. For the purposes of the STC, the amount of qualified basis is established as a part of the carryover allocation process and does not change thereafter.

The STC percentage depends on the development's location. Pursuant to state statute the Agency has designated each county as High, Moderate or Low Income, which corresponds to the 10%, 20% and 30%. (The county list can be found in the 2013 Qualified Allocation Plan ("QAP")).

Income Targeting Standards

An award of federal LIHTCs alone does not entitle an LLC/LP to claim the STC. The state statute goes beyond the federal income targeting requirement with more restrictive limits.

High Income county (two options):

- Fifty percent (50%) of the qualified residential units are affordable to households whose income is forty percent (40%) or less of the area median income.
- Twenty-five percent (25%) of the qualified residential units are affordable to households whose income is thirty percent (30%) or less of the area median income.

Moderate Income county: Fifty percent (50%) of the qualified residential units are affordable to households whose income is fifty percent (50%) or less of the area median income.

Low Income county: Forty percent (40%) of the qualified residential units are affordable to households whose income is fifty percent (50%) or less of area median income.

Projects must comply with these limits for thirty (30) years; these and other requirements will be incorporated into the project's extended use agreement.

Making the Election Between a Direct Refund and Agency Loan
As part of the full application for LIHTCs, LLC/LPs are required to indicate which of the two options for taking the STC they will elect. This choice will be based on a number of factors, and program participants will need to consult with professionals (i.e. attorneys and accountants) who are familiar with the STC and related legal issues to determine the best option. Federal LIHTC equity investors may also have an interest in the election.

The following chart describes the major distinctions between each option, which are further described in the remainder of this Appendix.

Direct Refund	Agency Loan
Project must be 50% complete, inspected and meet all requirements before funds may be issued from escrow	Can close when the project meets the Agency's requirements, including construction financing equals the loan amount, and the Agency has received the STC funds from the DOR
Subject to automatic, statutory recapture and penalties for non-compliance	Exempt from statutory recapture; compliance covered by the loan documents
Value will become partners' equity	Will be subject to repayment in year 30
Will result in federal taxable income recognition for partners	Excluded from federal income taxes if within terms of the private letter ruling ("PLR")

The LIHTC carryover agreement will have a section for project owners to elect the loan or direct refund method. However, any indication that is contrary to the representation made in the full application will result in revocation of the tax credit award.

Agency Loan Option
The loan will be zero percent (0%) interest, thirty year balloon (no payments). There is no requirement that 50% of the basis-eligible activities be completed prior to closing the loan. The Agency will also conduct a review of the standard due diligence items associated with commercial real estate transaction. As of the present time, half of the funds will be issued after July 1, 2014. Therefore the first disbursements of loan proceeds will not be until after that date and will be for no more than half the total amount of a loan. The other half will be issued after July 1, 2015. This timing of when funds will be available is subject to change.

The premise for the PLR is that the Agency will not have to provide an information return to ownership entities that have elected to receive the loan. The PLR holds that a recipient of a loan neither receives nor becomes entitled to receive a state credit for purposes of Section 61 and 451 of the Internal Revenue Code. The result of this conclusion is that the recipient of a loan does not receive and subsequently transfer its STC exchange for a loan. Accordingly, the transaction is treated for federal income tax purposes as a direct state loan to the recipient. No gain is recognized as a result of a deemed transfer of credit. The receipt of a loan from a state entity, even with a below-market interest rate, is not subject to federal income tax.

To achieve this federal income tax treatment, the loan must constitute indebtedness for federal income tax purposes; that is, the fair market value of the property exceeds the total amount of the indebtedness to which the property is subject and the ownership entity reasonably expects to repay the full amount of the loan in accordance with its terms.

There is also no possibility of statutory recapture under this option. Instead, failure to comply will be addressed by the Agency. This may include foreclosure of the loan, penalties applied to future applications for LIHTC or other Agency funding, and/or not being considered in good standing.

Direct Refund (Grant) Option
The LLC/LP may choose to receive a refund of the STC amount. Under this method the DOR will issue funds in the name of the LLC/LP to an escrow account held by the Agency. The account can only be closed when the development meets certain milestones. The most important of these is that at least half of the activities to be included in the project's qualified basis must be completed (see QAP Section VII(B)(2) for a complete description). The purpose behind these limitations is to ensure that resources are not claimed ahead of corresponding value being created in the buildings.

If an LLC/LP accepts a refund and subsequently fails to ensure that the development complies with the relevant requirements under the statute and QAP, its members/partners and related parties will be liable for recapture of the refund amount, in addition to other penalties (as determined by the Agency and DOR).

Regardless of the circumstances, a project cannot reflect payment of taxes owed due to electing the direct refund method. Any amount owed by a member or partner will be their responsibility and may not be included as a development cost, cash flow priority, reduced equity pricing or otherwise. This limitation will apply to all stages of the Agency's project review (i.e. application, carryover and final cost certification).

To date no LLC/LP has elected the direct refund option.

Contact Mark Shelburne at mshelburne@nchfa.com or (919) 877-5645 for more information.

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