Examples of Forms of Federal Subsidy for Affordable Housing

Basic Premise: Assume a developer develops a project of apartments at a total cost of $100,000 per unit. In return for a 15-year restriction on rents and on tenant incomes, the Federal government is willing to provide a subsidy of $60,000 per unit and he finances the balance with a 30-year mortgage. To be competitive to receive the subsidy, the developer agrees to extend the rent restriction for an additional 10 years. His annual operating results per unit are:

Total Revenue	$8,900	
Total Operating Expenses	3,900	(exclusive of property taxes)
Net Operating Income	5,000	
Debt Service	3,000	
Net Income	2,000	

Example One: The Federal government provides the subsidy in the form of a $60,000 **cash grant**.

Example Two: The Federal government provides the subsidy in the form of a **stream of payments** of $7,500 per year for 10 years. The developer does not need any subsidy for operations, so he monetizes the income stream from a lender for an up-front payment of $60,000. The lender, who has no legal interest in the ownership of the property, receives the $7,500 annual payments from the Federal government for 10 years.

Example Three: The Federal government provides the subsidy in the form of an **income tax credit** of $7,500 per year for 10 years. The developer cannot utilize the tax credits, so he forms a Limited Partnership and an investor buys into the Partnership for an upfront payment of $60,000. The investor is not involved in the operation of the property; he receives the annual benefit of the tax credits for 10 years, and once the 15-year compliance period is over he withdraws from the partnership.

In Examples One and Two, the value of the property for property tax purposes would be based on the Net Operating Income of $5,000; this might result in a property tax of $800. In Example Three, if the assessor added the $7,500 tax credit being received by the limited partner to the property's Net Operating Income, the imputed annual income would be $12,500 and the property tax would increase to $2,000. This would provide no operating cushion and would likely trigger a default on the mortgage loan for not meeting the contracted debt service coverage ratio.

Should there be any difference in the way that property tax is assessed between these three examples?