

# **PENNSYLVANIA HOUSING FINANCE AGENCY COST CERTIFICATION GUIDE TAX CREDIT PROGRAM**

**NOTE: THIS IS NOT AN AUTHORITATIVE PRONOUNCEMENT ON THOSE COSTS THAT ARE TAX CREDIT ELIGIBLE AND INELIGIBLE. IT SERVES ONLY AS A GUIDE.**

## **PURPOSE**

The purpose of the cost certification is to establish the actual total costs incurred by the taxpayer in order that the Total Development Cost, Depreciable Basis, Historic Tax Credit Basis, and Low-Income Housing Tax Credit (“Tax Credit”) Basis may be determined for purposes of preparing the IRS Form 8609, Low Income Housing Credit Allocation Certification. The costs must be within the parameters established in the Pennsylvania Housing Finance Agency (“Agency”) Multifamily Housing Program Guide, Development Cost Limits Schedule, and Fee Schedule in effect for the year in which the development initially received an allocation of Tax Credits.

The cost certification audit must be completed by an independent, third party Certified Public Accountant (“CPA”) who is familiar with the requirements of Section 42 of the Internal Revenue Code.

## **FORM OF CERTIFICATION**

The cost certification must be submitted on the form included with the Placed-In-Service Package which details the cost certification requirements for the Tax Credit Program. The CPA must complete all columns of this form. The cost certification must be accompanied by the Independent Auditor’s Report, in the form prescribed in the Placed-In-Service Package. The syndicator of the Tax Credits for the development must also certify that it has reviewed the cost certification and concurs with the contents. The syndicator’s letter must also identify the first year of the Tax Credit period.

**Be sure that all costs have been included in the cost certification and that all information is correct prior to submitting it to the Agency. Once submitted to the Agency, the cost certification cannot be amended or supplemented except as may be required by the Agency. It is the owner’s responsibility to review the cost certification in its entirety prior to its submittal to this Agency.**

## **REHABILITATION EXPENSES**

For rehabilitation expenditures to be treated as a separate new building eligible for the Tax Credit:

1. the expenditures must be allocable to one or more low-income units or substantially benefit such units, and

2. the amount of such expenditures during any 24-month period must meet the greater of the following requirements:
  - the amount is not less than 10 percent of the adjusted basis of the building, or
  - the qualified basis attributable to such expenditures, when divided by the number of low-income units in the building, is \$3,000 or more.(For buildings with credits allocated after July 30, 2008, the amount of such expenditures must be not less than 20 percent of the adjusted basis of the building, or \$6,000 per unit, subject to an inflation adjustment during any calendar year after 2009.)

Rehabilitation expenditures are treated as placed in service at the close of a 24-month period, and only those rehabilitation expenses incurred within the 24-month period prior to placing the project in service are eligible for Tax Credits. Note, however, that incidental costs incurred after the placement in service date up to the end of the first year of the credit period may also be included.

### **ELIGIBLE COSTS**

Prior to completing the cost certification, the Fee Schedule and Development Cost Limits Schedule in effect for the initial year of the allocation of Tax Credits should be reviewed to ascertain fee caps and limits, both for total development cost and Tax Credit eligible basis. For developments that have been allocated Tax Credits over more than one year, the initial year of the allocation of Credits will take precedence.

Total development cost may include:

- Construction costs
- Architect fees
- Professional fees, such as legal and accounting, appraisal and market study, engineering and survey
- Furniture and equipment
- Construction period interest and fees
- Financing expenses, including loan application fees, loan origination fees, and mortgage insurance premium
- Tax Credit allocation and monitoring fees
- Real estate taxes and property and liability insurance
- Title and recording expenses
- Development reserves
- Developer fee
- Syndication fees and expenses
- Compliance monitoring fee
- Rent-up expenses
- Relocation expenses

Contingencies, either for construction or soft costs, will not be permitted in total development cost. If a construction contingency was used for eligible construction

changes during construction, these costs should be reported on the change order line of the construction cost breakdown.

## **DESCRIPTION OF ELIGIBLE COSTS**

1. **CONSTRUCTION COST:** This is the amount due and paid or to-be-paid under the terms of the construction contract, as adjusted upward or downward by approved construction change orders, incentive payments, or liquidated damages. Amounts which may be included for general requirements, overhead, and profit are limited in accordance with the Development Cost Limits Schedule in effect for the year in which the development received an allocation of Tax Credits.

If the total construction cost reported on the cost certification includes owner-paid items or other costs paid outside of the construction contract, an itemized schedule of these costs, with invoices, must be submitted.

Required with the cost certification are executed copies of the final AIA Documents G702 (Application and Certificate for Payment), G703 (Continuation Sheet to AIA Document G702), and G704 (Certificate of Substantial Completion), along with copies of the approved change orders. The total construction cost shown in the cost certification should agree with the construction amount shown on the final form G-702. Any discrepancy must be documented and substantiated with invoices.

Off-site improvements, physical improvements that affect the use and the value of a parcel of land but are not directly located on the land, are not Tax Credit basis eligible. Examples include streets, curbs, open space and the portion of water and sewer lines located off the parcel of ground upon which the development will be built.

Fees for “Clerk of the Works” and construction managers must be included in the General Requirements of the construction cap. Refer to the Cost Limits Schedule for the cap limits for General Requirements.

2. **ARCHITECT DESIGN and CONSTRUCTION CONTRACT ADMINISTRATION:** This is the design and contract administration fee actually incurred by the taxpayer. These costs are limited by the levels established in the Development Cost Limits Schedule in effect for the year in which the development received its initial allocation of Tax Credits. Construction management fees must be included under the General Requirements of the construction contract. Architectural reimbursable expenses may be charged for drawings, specifications, distance traveled over 100 miles in a single trip and overnight lodging. Other fees that may be considered reimbursable must be included in the architect’s fee. Refer to the Cost Limits Schedule in effect for the initial year of Tax Credits for further clarification.
3. **CIVIL ENGINEERING:** These fees may be limited to 15% of the total of the Sitework and Off-site costs of the construction contract. Refer to the Cost Limits Schedule in effect for the initial year of Tax Credits.

4. **LEGAL:** Legal expenses are limited to those fees incurred for initial and final loan closings; tax advice during organization of taxpayer entity only; and preparation of documents and representation for and during organization of the taxpayer entity. Normally, the allowed expenses include only those customary expenditures expected to be incurred prior to and during initial loan closing and construction (but including legal expense for final loan closing). Legal expenses incurred in connection with the land and/or building acquisition must be shown under Land and Building. Fees are limited to invoices from only one member of a firm for internal meetings and conferences dealing with specific real estate matters. These costs are also limited by the levels established in the Development Cost Limits Schedule in effect for the year in which the development received its initial allocation of Tax Credits.

- Legal fees relating to the rehabilitation or new construction of a building that includes contract negotiation, Tax Credit research/issues, preparation of required closing and construction documents and supervision of the execution of the documents are includible in the “new building” basis.
- Legal fees associated with the development financing should be differentiated as either construction financing or permanent financing.
- Legal costs directly related to the acquisition of the property must be allocated between land and building based on their respective appraised values. Legal costs related to the acquisition of the building will only qualify for the Acquisition Tax Credit. Legal fees should not include the usual expenses connected with land acquisition already included in or contributing to the title and recording expenses.
- Legal fees related to the development syndication must be separated from the other legal fees and reported as syndication expenses. These fees are not Tax Credit basis eligible.
- Legal fees and expenses for groundbreaking, entertainment, or lobbying are not eligible.

5. **APPRAISAL:** For new construction developments, the cost of the as-is appraisal may not be included in Tax Credit eligible basis. For appraisals of existing buildings, that portion of the cost of the appraisal that is applicable to the value of the buildings, but not the land, may be included in Acquisition Tax Credit basis.

6. **COST CERTIFICATION/ACCOUNTING:** Accounting costs for audits or cost certifications are permitted charges.

Accounting charges relating to the syndication of the development, such as financial projections, annual partnership tax returns, or preparation of financial statements, must be shown under Syndication Fees and Expenses. Fees paid to an accountant for housing consultant services are not considered to be accounting fees for syndication purposes and must be paid from the developer fee.

If the project qualifies for Acquisition Tax Credits, a portion of the cost must be allocated to Acquisition Tax Credit basis.

7. **FURNITURE AND EQUIPMENT:** An itemized breakdown with supporting invoices is required. Interior design fees are considered to be consulting fees and must be paid

8. **CONSTRUCTION PERIOD INTEREST AND FEES:** If the construction and permanent financing is provided by the same financial institution, financing fees must be prorated over the life of the combined construction period and permanent loan term. Only that portion charged to the construction period is Tax Credit basis eligible.

Only interest during construction is Tax Credit basis eligible. For developments with multiple buildings having different placement-in-service dates, a schedule showing the placement-in-service date for each building, along with the corresponding interest charge for those buildings will be required. This spreadsheet should show the monthly accrual of construction period interest.

If any portion of a construction loan is bridging the equity pay-in, a proportionate amount of interest and fees must be charged to bridge loan interest and fees. For example, if a \$1,000,000 construction loan is being taken out by a \$200,000 permanent loan with the remainder being repaid through the equity installments, 80% of the interest and fees should be charged as bridge loan expenses.

9. **FINANCING EXPENSES, INCLUDING LOAN APPLICATION FEES, LOAN ORIGINATION FEES, AND MORTGAGE INSURANCE PREMIUM:** Only those financing fees applicable to the construction financing are includible in eligible basis. If the construction and permanent financing is provided by the same financial institution, fees charged during construction must be prorated over the life of the combined construction period and permanent loan term.

Financing fees related to a bridge loan must be reported as bridge loan fees.

10. **TAX CREDIT ALLOCATION FEES:** Agency fees assessed for Tax Credit Program participation are not Tax Credit basis eligible.

11. **REAL ESTATE TAXES:** Only those real estate taxes allocable to the construction period may be included in eligible basis. For developments that are occupied during construction, the costs must be prorated between capitalized costs and operating costs.

12. **INSURANCE:** This is the amount incurred by the taxpayer for the cost of property and casualty insurance for the same period over which interest is computed. The general contractor's builder's risk policy is part of the construction cost and must be included in the construction contract under either general requirements or builder's overhead.

13. **TITLE AND RECORDING EXPENSES:** Some of these expenses may be includable in Tax Credit eligible basis if a pro-ratio between land, building, and rehabilitation or new construction basis is calculated by the CPA.

14. **LAND AND BUILDING:**

Purchase price: allocated between land and building based on the lesser of the respective appraised values or the actual purchase price.

Title and recording fees: allocated to land and building based upon respective appraised values.

Transfer Tax: Only one-half of the assessed transfer tax (the buyer's portion) may be included in total development cost and, if applicable, the Acquisition Tax Credit basis.

Legal: Legal costs directly relating to the acquisition of the property are allocated to land and building based on respective appraised values. Note that legal costs for zoning issues which are directly associated with the properties acquisition are allocated to land.

Brokerage fee/sales commission: These fees are typically costs incurred by the seller, and therefore should not be included. Buyer's Agent fees, if applicable, should be allocated to land and building based on respective appraised values.

Demolition: the cost of demolishing existing buildings is allocated to land and is not Tax Credit basis eligible. If a portion of a building, such as an addition or a wing, is being taken down to the ground, this is considered building demolition, not selective demolition, and is not Tax Credit basis eligible.

Holding Costs: Certain costs of acquisition, including but not limited to utilities and real estate taxes, should be itemized separately from the land and building purchase, and supporting documentation in the form of paid invoices, satisfied tax liens, etc. should be submitted. Holding costs and carrying charges incurred prior to the date of the initial application will not be recognized in total development cost. For Rehabilitation Tax Credit projects, holding costs incurred outside of the 24-month period over which costs may be incurred will not be recognized in total development cost.

15. DEVELOPMENT RESERVES: Only those reserves approved by the Agency in its underwriting are allowable costs to be recognized on the cost certification. Any additional reserves must be paid from the developer fee.

For all reserves included in total development cost, the limited partnership agreement must include a provision addressing the terms and conditions for disbursement from the reserve, and must specifically state that in the event the reserve is not used for its intended purpose, any funds remaining in the reserve at the end of the compliance period or sale of the property, whichever is earlier, must be used to reduce any outstanding debt on the development.

16. DEVELOPER FEE: The Agency will not recognize a higher developer fee than was approved on the initial Worksheet. If costs have decreased, the developer fee may be decreased if it exceeds the maximum allowable amount.

17. RENT-UP EXPENSES: This typically includes payroll for both the assigned staff as well as any additional staff needed to assist in renting the property, office supplies, expenses for an open house, utility bills for units not yet rented, marketing costs, etc.,

18. RELOCATION EXPENSES: These may include both the cost of moving to a temporary unit and moving back to the replacement unit, utility charges, storage units, on-site hospitality room, etc. A breakdown of these charges should be included with the cost certification.

### **INELIGIBLE COSTS**

1. ORGANIZATIONAL EXPENSES. Organizational costs are not permitted in total development costs. All organizational expenses must be paid from the developer fee.
2. CONSULTANT FEES. Consultant fees may not be shown separately in total development costs. These fees must be paid from the developer fee. For developments utilizing historic rehabilitation tax credits, however, a reasonable historic consultant fee will be allowed in both total development cost and eligible basis. This fee is limited to the lesser of  $\frac{3}{4}$  of 1% of the eligible basis for the historic rehabilitation tax credit or \$30,000.

### **DEMOLITION**

The cost of a building that is razed is a non-depreciable land cost. This cost is not eligible for Tax Credits, and should be reported under the land cost category. Interior demolition completed as part of the construction rehabilitation contract, however, is an eligible cost and should be included in the construction cost category of the cost certification.

### **COMMERCIAL SPACE**

For developments that contain commercial space or space that the tenants will be charged to use, the cost of this space is not includable in eligible basis. A worksheet showing the calculation of the eligible basis deduction to the cost certification for the commercial space must be provided.

### **COMMUNITY BUILDING**

A building or portion thereof providing supportive services to a transitional housing program may be included in eligible basis. Qualified basis is the lesser of the eligible basis used for supportive services or 20% of the building without regard to the portion providing supportive services.

The cost of community service facilities, defined as any facility designed to serve primarily individuals whose income is 60 percent or less of area median income, located within a qualified census tract may also be included in eligible basis. The amount included in Tax Credit basis cannot exceed 10 percent of the eligible basis of qualified low-income housing project of which it is a part. For purposes of calculating the 10 percent increase in eligible basis, all community service facilities which are part of the

same low-income housing project are treated as one facility. (For buildings placed in service after July 30, 2008, the amount included in eligible basis for a community service facility increases from 10 percent of the eligible basis of the low-income housing project to 25 percent of the housing project, up to \$15,000,000, plus 10 percent of the cost of the project that exceeds \$15,000,000.)

For scattered site developments on noncontiguous tracts of land, the community building must contain at least one residential rental unit in order for the cost of the community building to be includable in Tax Credit eligible basis.

### **INTERIM INCOME (INCOME DURING CONSTRUCTION)**

For a building that is occupied during the construction period:

If there is a construction loan, that is, the owner is paying interest only on the loan and no principal, the interest (as well as taxes and insurance) is allowable in tax credit basis. If there is no construction loan, however, and the owner is paying both principal and interest, these costs are not basis eligible.

If the full cost of construction period interest, real estate tax, and property insurance are included in total cost, net income during construction must be calculated and included as a funding source.