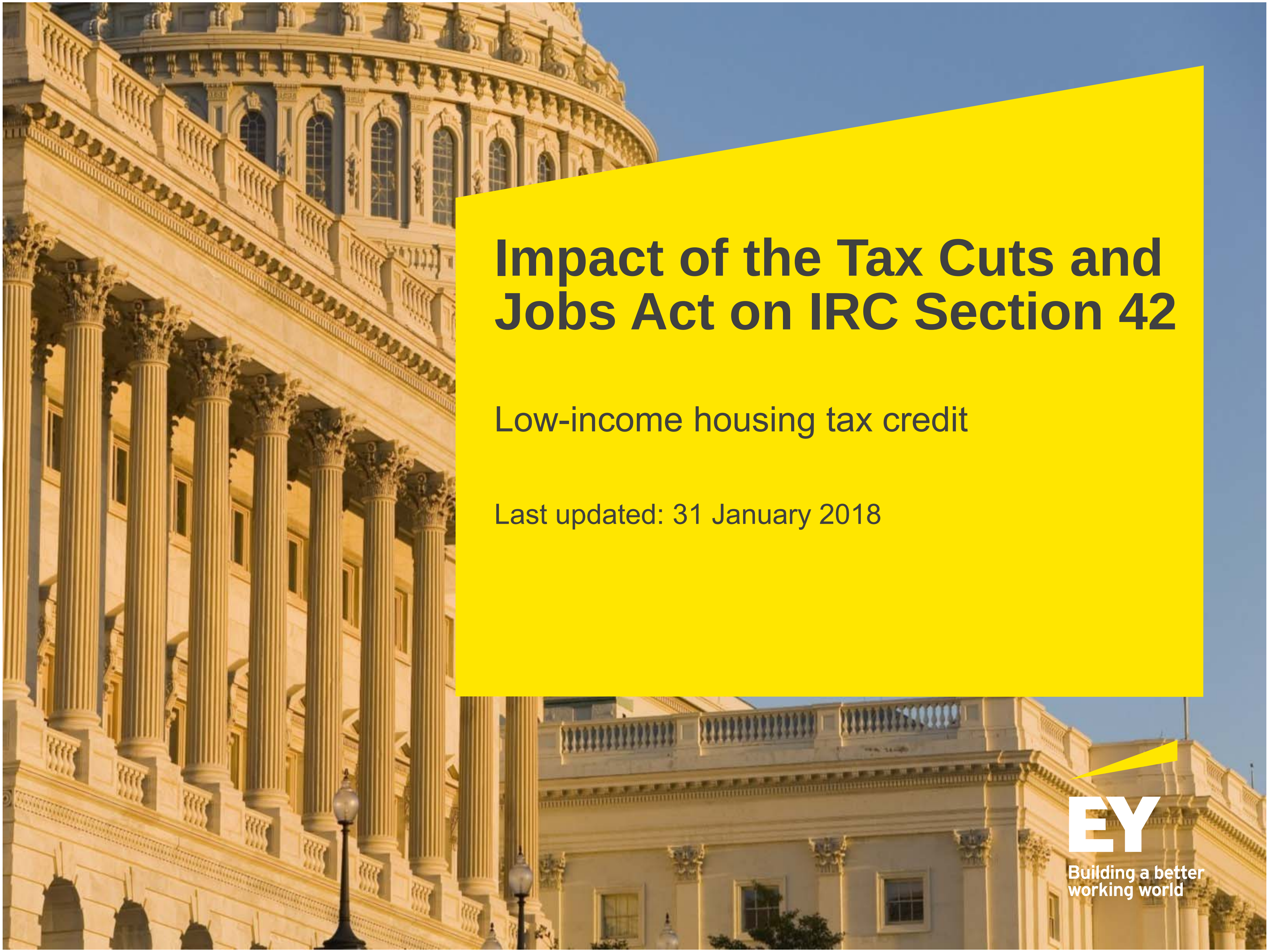

Impact of the Tax Cuts and Jobs Act on IRC Section 42

Low-income housing tax credit

Last updated: 31 January 2018

Building a better working world

Disclaimer

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Introduction

- H.R. 1, the Tax Cuts and Jobs Act (TCJA), was signed into law on 22 December 2017, by President Trump.
- The intent of the legislation is to spur economic growth through, among other things, a lowering of individual and corporate income taxes and moving the US to a territorial system of business taxation.
- Prior versions of the bill in the House and Senate contained provisions that could have had significant negative impacts on the low-income housing tax credit (LIHTC) industry; however, through the process of reconciliation, many of these concepts were removed from or modified in the TCJA.
- Nonetheless, the TCJA has a number of provisions that will impact LIHTC investments, which are summarized in the following presentation, including a discussion of the applicable provisions, their respective impact on sample investments, and potential market implications.

How does the TCJA impact LIHTC investments?

Direct impacts to LIHTC investments

- LIHTC retained
  - 30% basis boost preserved
  - Federal income tax exemption for private activity bonds (and the 4% LIHTC) retained
    - One minor change to calculation for annual inflation adjustments, which will impact the annual volume cap
- Corporate tax rate declines from 35% to 21% starting in 2018
- Net interest expense deduction limited to 30% of adjusted taxable income (earnings before interest, taxes, depreciation and amortization or EBITDA) through 2021 and 30% of earnings before interest and taxes (EBIT) thereafter
  - Real property trade or business can elect out of the limitation (i.e., fully deduct net interest expense) if real property depreciated over the alternative depreciation system life (i.e., 30 years for residential rental properties as modified by the bill)

Direct impacts to LIHTC investments

- Full and immediate expensing or 100% bonus depreciation for certain business assets with a recovery period of 20 years or less (i.e., personal property and site improvements) placed in service after 27 September 2017, with a phase out after 2022
- Modified Accelerated Cost Recovery System (MACRS) depreciable life for residential rental property retained at 27.5 years
- Section 708 partnership technical termination rule repealed
  - Depreciation periods no longer need to be reset upon transfer of more than 50% of the partnership interest
  - Positive impact for secondary market transactions, as the deductions will no longer be slowed down by a depreciation reset, which should theoretically result in better pricing and help offset the impact of a lower tax rate for potential sellers of LIHTC transactions

Indirect impacts to LIHTC investments

- Modified taxation of foreign income (i.e., Base Erosion and Anti-Abuse Tax or BEAT)
  - A new alternative tax calculation for foreign-owned corporations or US corporations with significant foreign operations to prevent large corporations from using cross-border payments to affiliates to considerably reduce their US taxes
    - Calculated as the excess of:
      a) 10% (increases to 12.5% after 2025) of “modified taxable income,” less
      b) The taxpayer’s regular tax liability after reduction for certain tax credits
    - Modified taxable income in item A above defined as taxable income plus deductible cross-border payments to affiliates and a percentage of any tax losses claimed that were carried from another year
    - Increased rate of 11% (13.5% after 2025) of modified taxable income for banks and securities dealers
    - 80% of the LIHTC’s value exempt from this tax through 2025 (with no exemption thereafter) in order to narrow the gap between items A and B (i.e., up to 80% of the LIHTC will be added back to B through 2025)
  - Creates additional tax planning complexities and challenges surrounding LIHTC investments given the 10-year credit horizon and expiration of the 80% offset after 2025

Indirect impacts to LIHTC investments

BEAT – numeric example

Calculation of the base erosion anti-abuse tax

(A) 10% of taxpayer's modified taxable income		(B) Regular tax liability, less certain credits	
Regular taxable income	$1,000	Regular taxable income	$1,000
Payment to related foreign entity for services	$150	Regular tax rate	21%
Modified taxable income	$1,150	Regular tax before credits	$210
BEAT rate	10%	Tax credits	<$80>
BEAT minimum tax	$115	Regular tax liability	$130

BEAT = the positive difference between (A) less (B):
(A) – (B) = <$15>; BEAT = 0

Indirect impacts to LIHTC investments

- Retains 20% historic tax credit (HTC) with some modifications
  - Credit will be claimed over five years instead of in year one upon placement in service.
  - Unlike the LIHTC, HTCs do not offset the BEAT.
    - May be problematic for LIHTC deals that are “twinned” with HTCs
- 10% rehabilitation credit for buildings built before 1936 repealed
- Alternative minimum tax (AMT) for corporations repealed
  - Eliminates some complexity surrounding calculation of corporate taxes
- Deduction for net operating losses (NOLs) limited to 80% of taxable income starting in 2018
  - Carryback of NOLs repealed with some exceptions.
  - NOLs can be carried forward indefinitely.

How does the TCJA impact future LIHTC investments?

Impact of tax reform on new LIHTC investments

- The upcoming section will evaluate the impact of the following items on sample fund and property investments representative of those in the market prior to the enactment of the TCJA.
  - Lower effective tax rate
  - Immediate expensing
  - Limitation on interest deductions

Lower effective tax rate

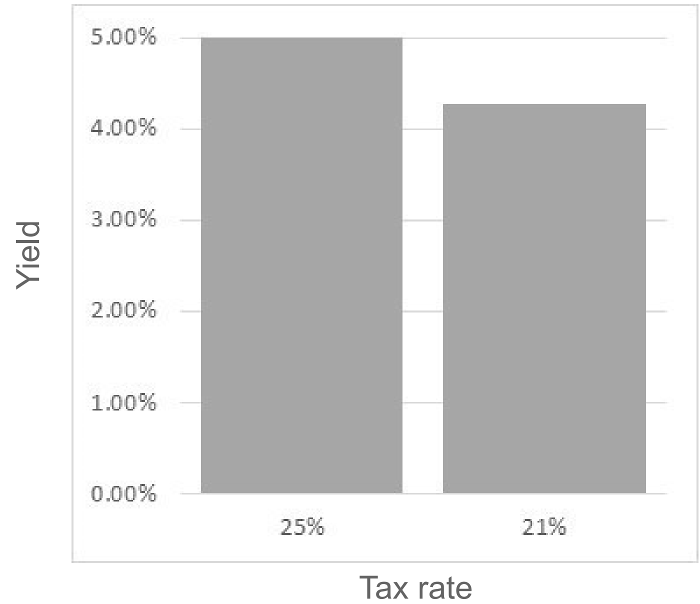
Lower effective tax rate

- In LIHTC investments, tax credits are delivered over a 10-year period while taxable losses are recognized over 15 years.
- While the timing of the taxable losses varies, the total amount of taxable losses is equal to the investment amount.
  - Therefore, a $1 investment for $1 of tax credits generates $1.35 of benefits at the former 35% corporate tax rate [$1 of tax credits + ($1 of losses * 35%)].
- Under the TCJA, the corporate tax rate was lowered from 35% to 21%, which reduces the value of the taxable losses received.
  - Therefore, all else equal, a $1 investment for $1 of tax credits would generate $1.21 of benefits at the 21% corporate tax rate.
- The reduced value of taxable losses due to the lower corporate tax rate results in less investor equity being contributed and could create the need for additional sources to fill financing gaps.
- A reduction in investor demand resulting from a lower tax appetite may drive up investment yields, further reducing the amount of equity available to a given transaction.
- In order to illustrate the impact of a lower tax rate on yield, we have utilized a sample fund investment representative of a fund in the market prior to the enactment of the TCJA as shown on the following slide.
  - The sample investment assumes a 25% corporate tax rate, which was a typical underwriting parameter over the past year in anticipation of tax reform.

Sample base case investment at 25% tax rate

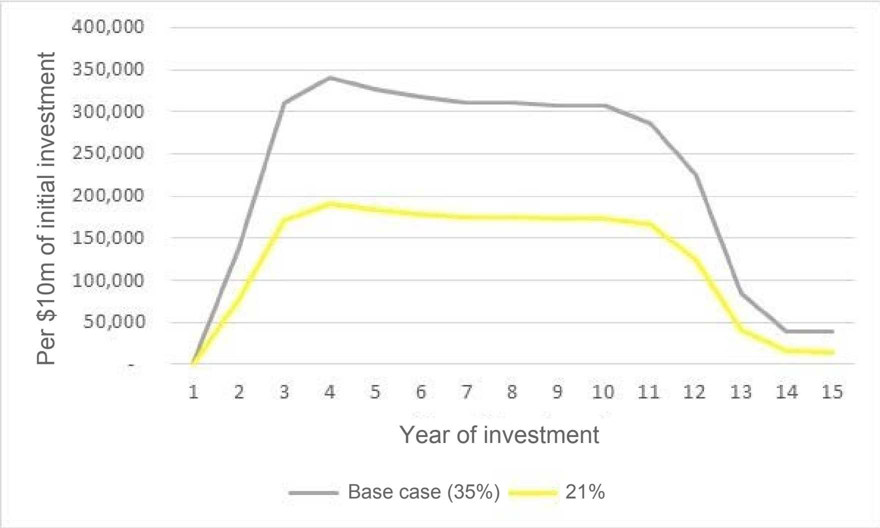
Year	Capital contributions	LIHTC	Taxable income (losses)	Taxable benefits	Total projected benefits
1	1,500,000	6,094	(10,581)	2,645	(1,491,261)
2	1,037,819	414,227	(326,933)	81,733	(541,859)
3	5,599,930	911,426	(795,107)	198,777	(4,489,728)
4	1,625,420	1,043,412	(735,514)	183,878	(398,129)
5	104,640	1,011,707	(677,296)	169,324	1,076,391
6	132,191	978,725	(679,122)	169,780	1,016,314
7		978,389	(593,326)	148,331	1,126,721
8		978,365	(598,252)	149,563	1,127,928
9		978,359	(563,611)	140,902	1,119,261
10		978,359	(565,150)	141,288	1,119,646
11		978,359	(330,082)	82,521	1,060,879
12		644,393	(622,019)	155,505	799,898
13		146,908	(494,314)	123,579	270,486
14		-	(433,374)	108,344	108,344
15		-	(423,465)	105,866	105,866
16		-	(431,613)	107,903	107,903
17		-	(885,953)	221,488	221,488
18		-	(834,288)	208,572	208,572
Total	**10,000,000**	**10,048,723**	**(10,000,000)**	**2,500,000**	**2,548,723**
			Corporate tax rate		25%
			Yield		5.01%
			Credit to capital ratio		1.00
			Price per credit		1.00

Impact of lower effective tax rate on yield



- There is a linear relationship between tax rate and yield, with a lower tax rate resulting in a lower yield.
- The yield on our sample fund declines 74 basis points (bps) at the lower tax rate shown above, all else equal.
- The price per credit for our sample fund must decrease by approximately 3 cents to maintain the base case yield.

Impact of lower effective tax rate on after-tax earnings using Accounting Standards Update (ASU) 2014-01's proportional amortization method



- While the sample fund was priced at a 25% tax rate, earnings were still projected at a 35% tax rate (in accordance with ASU 2014-01) prior to tax reform. As such, the base case scenario above reflects the after-tax earnings for our sample investment at a 35% tax rate.
- Similar to the impact of a lower tax rate on yield, after-tax earnings (net of amortization) decline at a lower tax rate.
- The greatest impact occurs in years 3 through 11 of the investment period and then levels off thereafter.
- This assumes there is no adjustment to price per credit to offset a lower tax rate; a lower price per credit would reduce the negative impact of a lower tax rate on earnings.

Immediate expensing

Immediate expensing background

- Residential real estate, site improvements and personal property are depreciated under the MACRS or, in some cases, under the Alternative Depreciation System (ADS).
  - MACRS – 27.5, 15 and 5 years, respectively
  - ADS – 30 (as modified by the TCJA), 20 and 12 years, respectively
- TCJA permits a 100% first-year deduction of qualified property (i.e., certain depreciable personal property and site improvements) placed in service after 27 September 2017, and before 1 January 2023, to spur new investments
  - Bonus depreciation amount phases down thereafter:
    - 80% in 2023
    - 60% in 2024
    - 40% in 2025
    - 20% in 2026
    - 0% in 2027 and beyond
  - The total amount of deductions does not change, but the timing of such deductions is accelerated.

Immediate expensing background

- It is important to evaluate potential IRC Section 704(b) issues with respect to capital account maintenance, which could be caused by or exacerbated by bonus depreciation.
  - If the investor’s capital account becomes negative during the tax credit compliance period and minimum gain is insufficient, taxable benefits (including tax credits if during the credit delivery period) would be reallocated away from the investor.
  - Deficit restoration obligations (DRO) in which an investor is obligated to restore a deficit balance in their capital account when the partnership liquidates are rarely used since the partnership must generate enough income to restore the capital account before liquidation (or foreclosure) to prevent the investor from having to make an additional capital contribution.
    - The benefit of a DRO is limited to timing in situations where the partnership does not otherwise generate taxable income in the later years. As such, it is unlikely that DROs will become more prevalent for transactions in the market.
  - If bonus depreciation will not be taken, an affirmative election out of bonus depreciation needs to be made on the tax return in which the applicable asset is placed in service.

Impact of immediate expensing on tax benefits from depreciation losses

- To illustrate the impact of immediate expensing, the table below reflects the net present value of tax benefits from depreciation losses at a 21% tax rate for a sample $10m asset ($8.5m real property, $1.0m site work and $500,000 personal property) that elected out of bonus depreciation for site work and personal property, compared to 50% bonus depreciation (which was permitted for eligible property placed-in-service before 31 December 2017, prior to the enactment of the TCJA) and 100% bonus depreciation scenarios.

Year	No bonus depreciation	50% bonus depreciation	100% bonus depreciation
1	15,989	169,551	323,114
2	125,547	95,228	64,909
3	107,513	86,211	64,909
4	96,070	80,490	64,909
5	91,518	78,214	64,909
6	88,570	76,739	64,909
7	77,309	71,109	64,909
8	77,309	71,109	64,909
9	77,309	71,109	64,909
10	77,309	71,109	64,909
11	77,309	71,109	64,909
12	77,309	71,109	64,909
13	77,309	71,109	64,909
14	77,309	71,109	64,909
15	77,309	71,109	64,909
NPV @ 6%*	$794,705	$834,354	$874,002

**A 6% discount rate was used to be consistent with current yields on national multi-investor funds.*

- As shown, the tax benefits from depreciation losses are significantly higher in year one with bonus depreciation on qualified property, resulting in a higher net present value (NPV).

Limitation on interest deductibility

Limitation on interest deductibility background

- For LIHTC deals, interest deductions generate taxable losses for investors and are, therefore, part of the overall benefit stream of an investment.
- TCJA limits net interest expense deductions to 30% of EBITDA through 2021 and 30% of EBIT thereafter in order to eliminate the tax incentive to incur debt.
  - Disallowed amounts of net interest expense deductions can be carried forward indefinitely.
  - Real property trade or business may make an irrevocable election out of the limitation (i.e., fully deduct interest expenses) if nonresidential real property, residential rental property and qualified improvement property are depreciated under the ADS.
    - Election may be made at any point during the investment period.
    - When the election is made for residential rental property placed in service on or after January 1, 2018, a 30-year ADS recovery period (as modified by the bill) will be required.
    - Ambiguity exists in the TCJA with respect to assets placed in service prior to 2018 that make the election, with IRS guidance required.
      - TCJA does not describe whether the election of real property trade or business would be a "change in use" (which would require a change in the existing depreciation schedule to ADS life) even though it was described as such in the Senate version of the bill.
        - Informal feedback from the IRS suggests that a change in use was the intent of the legislation.
      - TCJA does not indicate whether residential rental property placed in serve prior to 2018 will need to use the former ADS recovery period of 40 years as opposed to the revised 30-year period, but we view the 40-year period as the better technical position.
- The chart on the following slide examines eight LIHTC properties to determine the representation of interest deductions as a percentage of each deal's total taxable losses across various deal structures.

Examination of property interest deductions

Property	Credit type	Hard debt/total development costs	Total debt/total development costs	Interest-bearing deferred development fee	Interest as % total taxable losses (average)*
1	9%	4%	4%	Yes	11%
2	9%	0%	10%	No	28%
3	9%	15%	15%	Yes	32%
4	9%	24%	57%	Yes	38%
5	4%	23%	59%	No	67%
6	4%	27%	49%	Yes	73%
7	4%	45%	63%	Yes	88%
8	4%	59%	69%	No	109%

* The percentage of interest relative to the total taxable losses varies in each year of the investment, typically with interest comprising a larger percentage of the total taxable losses in the early years of the investment and a lesser percentage in the later years of the investment.

Examination of property interest deductions

- Since 4% credit deals are generally more highly leveraged than 9% credit deals, it is not surprising that interest deductions represent a larger percentage of the taxable losses in these deals.
  - 67% to 109% for 4% credit deals
  - 11% to 38% for 9% deals
- Within each credit type (4% or 9%), interest deductions still vary widely and are dependent upon a number of factors, including:
  - Deal leverage
  - Interest rates on debt
  - Size of and interest rate on the deferred development fee
  - Amount of net operating income (i.e., size of operating cushion)
- With a limitation on interest deductions, total deductions remain the same (equal to the investment amount), but the timing of the deductions will change.
  - Fewer taxable losses received over the 15-year period and a larger capital loss at the end of the investment period to bring the capital account to zero

Examination of property interest deductions

- EBITDA and EBIT, which are components of the interest rate deduction calculation in the TCJA, were also analyzed for the sample properties:
  - All of the sample properties were underwritten with positive EBITDA and with interest expense deductions well exceeding the 30% cap in almost every year given that LIHTC properties are generally structured with minimal cash flow and/or fees that strip out cash.
  - All but one of the properties (with unusually high net operating income) was underwritten with negative EBIT (applicable after 2021), which would prevent interest deductions from being taken in these years.
  - Consequently, most properties will likely elect 30-year depreciation for real property under the ADS to allow for the full interest expense deduction.

Examination of property interest deductions

- The charts below depict the interest expense deductions as a percentage of the EBITDA/EBIT as well as the impact of the interest deduction limitations on two of the sample properties.

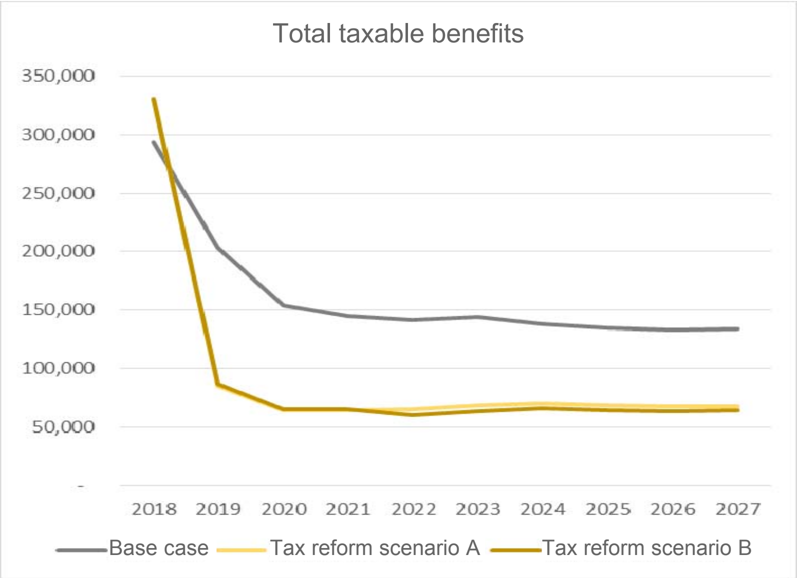
Property 1 9% deal; hard debt is 4% of TDC*	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**
Interest expense	–	21,824	56,522	55,062	53,646	52,294	51,020	49,875	48,852	47,977
EBITDA through 2021/EBIT after 2021	(14,078)	(22,643)	93,328	91,847	(350,647)	(360,599)	(344,324)	(337,039)	(333,376)	(335,165)
Interest expense as a percentage of EBITDA/EBIT	N/A	N/A	61%	60%	N/A	N/A	N/A	N/A	N/A	N/A
Interest expense deduction allowed	–	–	27,998	27,554	–	–	–	–	–	–
Disallowed interest expense	–	21,824	28,524	27,508	53,646	52,294	51,020	49,875	48,852	47,977
Property 2 4% deal; hard debt is 59% of TDC*	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**
Interest expense	44,264	526,423	661,478	721,640	720,625	719,363	717,857	716,111	714,130	711,923
EBITDA through 2021/EBIT after 2021	75,711	962,516	965,843	987,277	132,121	89,853	78,096	129,581	157,287	165,072
Interest expense as a percentage of EBITDA/EBIT	58%	55%	68%	73%	545%	801%	919%	553%	454%	431%
Interest expense deduction allowed	22,713	288,755	289,753	296,183	39,636	26,956	23,429	38,874	47,186	49,522
Disallowed interest expense	21,551	237,668	371,725	425,457	680,989	692,407	694,428	677,237	666,944	662,401

**Total development costs*

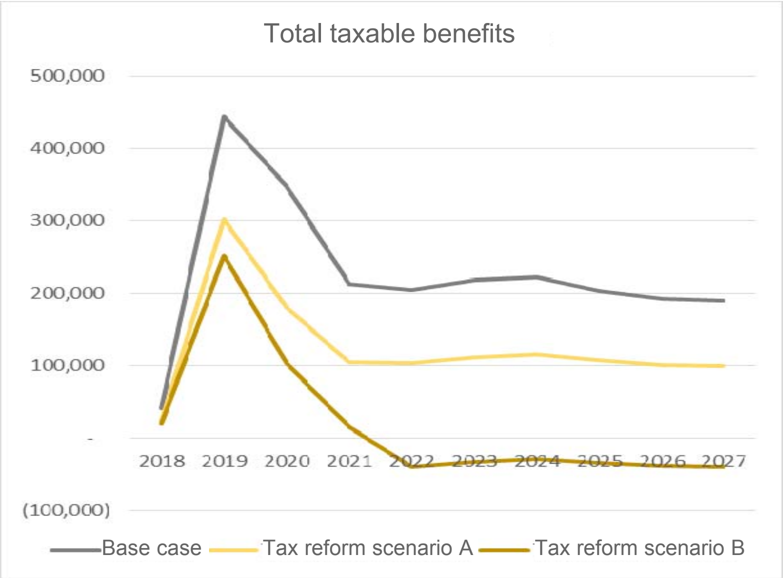
Examination of property interest deductions

- The charts below depict the impact of the interest expense deduction limitations on the total taxable benefits of two of the sample properties under the following scenarios:
  - Base case – 35% tax rate, 50% bonus depreciation (as permitted prior to the TCJA), full interest expense deductions, 27.5-year real property depreciation
  - Scenario A – 21% tax rate, 100% bonus depreciation, full interest deductions, 30-year real property depreciation
  - Scenario B – 21% tax rate, 100% bonus depreciation, limited interest deductions, 27.5-year real property depreciation

Property 1: 9% deal; hard debt 4% of TDC



Property 2: 4% deal; hard debt 59% of TDC



Examination of property interest deductions

- Both tax reform scenarios on the previous slide result in fewer taxable benefits relative to the base case scenario, which reflects a 35% tax rate and full interest expense deductions.
- The variance between Scenarios A and B is minimal for Property 1, suggesting that the determination between limited interest expense deductions and full interest deductions with slightly extended depreciation is immaterial for properties with low hard debt leverage, particularly when there is also negative EBIT after 2021.
- For Property 2, total taxable benefits are higher under Scenario A (full interest deductions and 30-year real property depreciation) compared to Scenario B (limited interest deductions and 27.5-year real property depreciation), suggesting that the determination between the interest expense deduction limitation versus the election out of the limitation will be an important consideration when structuring such deals.
- Scenario A assumes that the election out of the interest expense deduction limitation is made in year one; however, since the election can be made in future years, the facts and circumstances of each investment should be evaluated to determine the most advantageous time to make the election.

Property interest deductions for multitiered partnership structures

- As previously mentioned, interest expense deductions are limited to 30% of EBITDA prior to 2021 and EBIT thereafter under the TCJA, with disallowed amounts (i.e., amounts above the 30% cap) permitted to be carried forward indefinitely.
- The permissible interest expense deduction is determined at the partnership level, with any excess interest expense allocated to the partners, though the TCJA is vague on how these allocations should be made.
  - Preferred approach is to follow bottom-line taxable income after taking into account 704(c) until IRS guidance is provided
- Determining the amount of the interest deduction and the carryforward of excess interest expense becomes complex with multitiered partnership structures and there is no guidance in the TCJA.
  - Preferred approach is an “entity approach” rather than an “aggregate approach”; whereby, the calculation of permissible interest expense occurs at each entity level and each upper-tier partnership is treated as a “partner” taking into account its share of any excess business interest
  - Becomes increasingly challenging as partners and partnership interests change over time with IRS guidance needed

Conclusion

Impact of the TCJA on new investments

Overall observations

- Lower effective tax rate
  - It decreases the value of the taxable losses and therefore the Internal Rate of Return (IRR).
  - The yield on the sample $10m fund declines 74 bps following a decline in the tax rate from 25% to 21% and the price per credit must decrease by 3 cents to maintain the yield.
  - Similarly, the benefits under Generally Accepted Accounting Principles (GAAP) of the investment are reduced, with most of the reduction happening between years 3 and 11 of the investment.
- Immediate expensing
  - 100% first-year deduction for qualified property (i.e., site work and certain depreciable personal property) through 2022 with a phaseout thereafter.
  - The total amount of deductions generated by the investment remains the same, but the timing is accelerated, resulting in a boost in yield.
  - It is important to evaluate potential 704(b) issues that may result from or be exacerbated by bonus depreciation.

Overall observations

- Limitation on interest deductions
  - Interest deductions capped at 30% of EBITDA through 2021 and of EBIT thereafter or full interest deductions can be taken if the real property is depreciated under the ADS life of 30 years as modified by the TCJA.
  - Total deductions remain the same, but the timing of the deductions changes, with a larger capital loss at the end of the investment period.
  - Based on a review of a cross-section of deals, all properties had interest deductions well in excess of the 30% of EBITDA cap (since they are structured with little-to-no cash and/or fees that strip out cash) and all but one had negative EBIT, which results in no interest deductions after 2021. As such, most properties will likely elect 30-year depreciation for real property early in the asset life to allow for full interest expense deductions.
    - This determination is of particular importance for properties with a large amount of hard-debt leverage while it is less material for properties with low hard-debt leverage, particularly if there is also negative EBIT after 2021.
  - There is ambiguity in the TCJA surrounding the allocation of excess business interest to partners in multitiered partnerships with IRS guidance required.

How does the TCJA impact existing investments?

Background

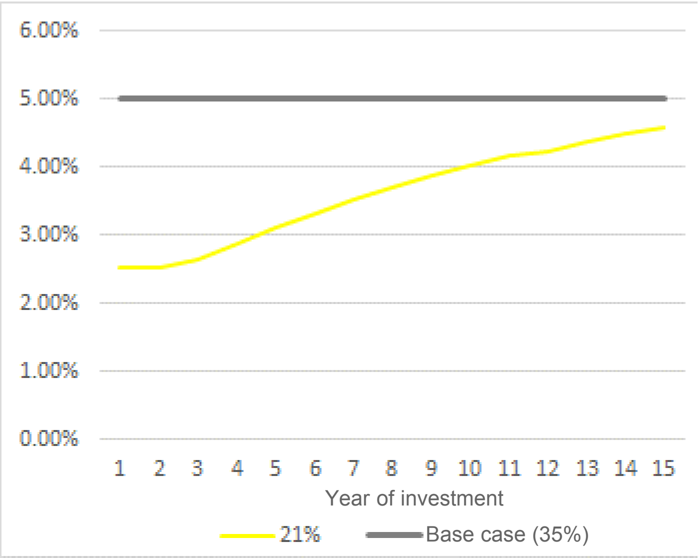
- The focus so far has been on future investments, but the TCJA also impacts seasoned investments. As such, this section attempts to look at the impact of tax reform on investments of different ages. Although it is not possible to change previous investments, it is nonetheless important for investors to understand the potential impact on both their return and GAAP earnings. The following slide reflects a sample $10m investment at a 35% tax rate which is the basis for the analysis. Over the last 15 years, yields and fund composition have changed; however, attempting to recreate the market conditions for each year would have added a significant degree of difficulty and provided nominal instructive benefit to the reader. Investors are encouraged to conduct a similar analysis on their particular portfolio.

Sample base case investment at 35% tax rate

Year	Capital contributions	LIHTC	Taxable income (losses)	Taxable benefits	Total projected benefits
1	1,500,000	5,555	(10,581)	3,703	(1,490,742)
2	1,037,819	377,600	(326,933)	114,426	(545,793)
3	5,599,930	830,835	(795,107)	278,287	(4,490,808)
4	1,625,420	951,151	(735,514)	257,430	(416,839)
5	104,640	922,249	(677,296)	237,054	1,054,662
6	132,191	892,183	(679,122)	237,693	997,685
7		891,877	(593,326)	207,664	1,099,541
8		891,855	(598,252)	209,388	1,101,244
9		891,849	(563,611)	197,264	1,089,113
10		891,849	(565,150)	197,803	1,089,652
11		891,849	(330,082)	115,529	1,007,378
12		587,414	(622,019)	217,707	805,120
13		133,918	(494,314)	173,010	306,928
14		-	(433,374)	151,681	151,681
15		-	(423,465)	148,213	148,213
16		-	(431,613)	151,064	151,064
17		-	(885,953)	310,083	310,083
18		-	(834,288)	292,001	292,001
Total	**10,000,000**	**9,160,184**	**(10,000,000)**	**3,500,000**	**2,660,184**
			Corporate tax rate		35%
			Yield		5.01%
			Credit to capital ratio		0.92
			Price per credit		1.09

Impact of lower effective tax rate on yield

- A decline in the tax rate has the greatest negative impact on yield in the earlier years of the investment period, with the variance relative to the base yield dwindling for more seasoned investments since a larger proportion of the tax deductions have already been recognized at a higher tax rate.
- The chart below depicts the impact of a lower effective tax rate of 21% on yield for the sample fund by year of the investment period in which the change occurred.



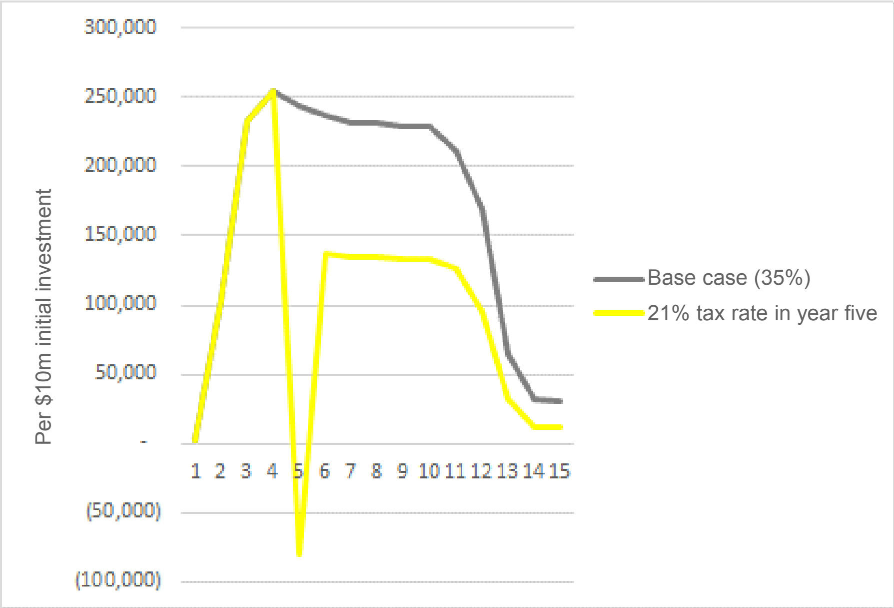
GAAP impact of lower effective tax rate on investments accounted for under ASU 2014-01's proportional amortization method

- The GAAP impact on your investment should be determined via a two-step process.
- **Step 1:** Test for impairment (i.e., is the future nominal value of your benefits below your carrying value?)
  - Impairment amounts should be reflected above the pretax income line.
  - Likelihood of impairment is dependent upon various factors, including price paid for the projected benefits and age of investment (more likely to occur with high price per credit investments and/or more seasoned investments that are beyond the credit delivery period).
- **Step 2:** Calculate the investment's one-time "catch-up" amortization
  - The lower tax rate results in lower tax benefits for the remaining years of the investment and correspondingly, lower total tax benefits. As such, the tax benefits you already received as a percentage of your new total tax benefits is now higher than it was before the change in the effective tax rate.
    - A one-time adjustment to book value would be made to reconcile the variance between the investment amount net of amortization at the 35% tax rate and the net investment amount at the 21% tax rate.

GAAP impact of lower effective tax rate on investments accounted for under ASU 2014-01's proportional amortization method

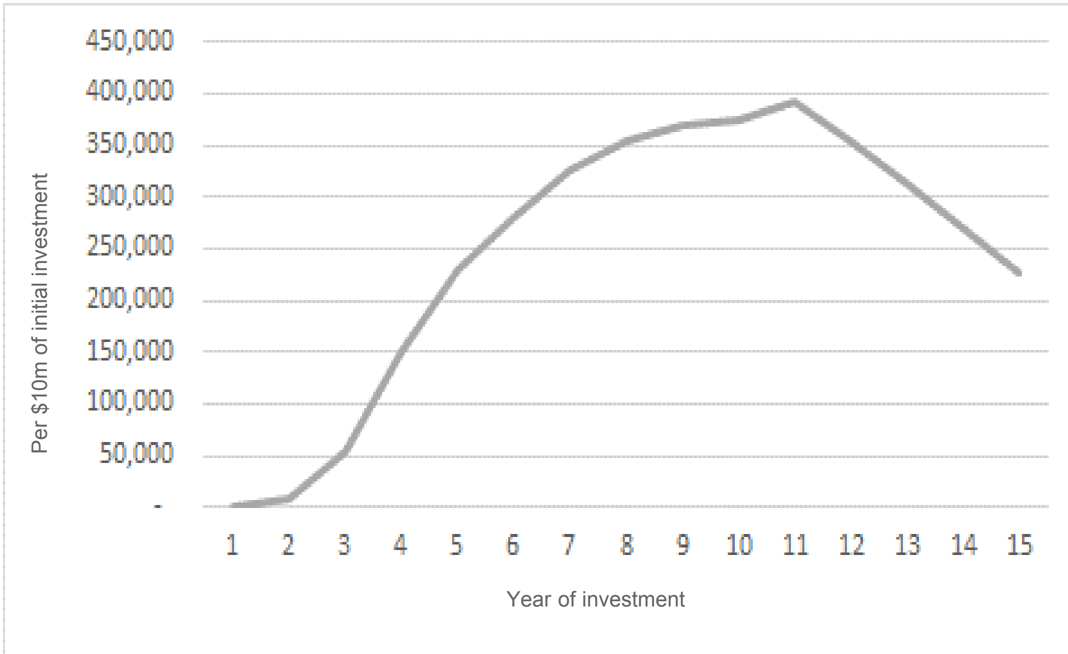
- **Step 2:** Calculate the investment's one-time "catch up" amortization (continued):
  - The one-time catch-up amortization should be reflected in Q4 2017 reporting, though the Financial Accounting Standards Board may permit a reasonable estimate in order to meet filing deadlines, with an update provided at a later date.
  - The catch-up amortization would be accounted for in the tax provision section of the financial statements (below the pretax income line).
  - For illustrative purposes, the charts on the following slides depict the one-time amortization adjustment's impact on earnings assuming the tax rate changed to 21% in year five of the investment as well as the adjustment amount (in dollar terms and as a percentage of current carrying value) based on the age of the investment at the time the tax rate changed for the sample $10m investment.

Impact of lower effective tax rate on after-tax earnings – tax rate change effective in year five



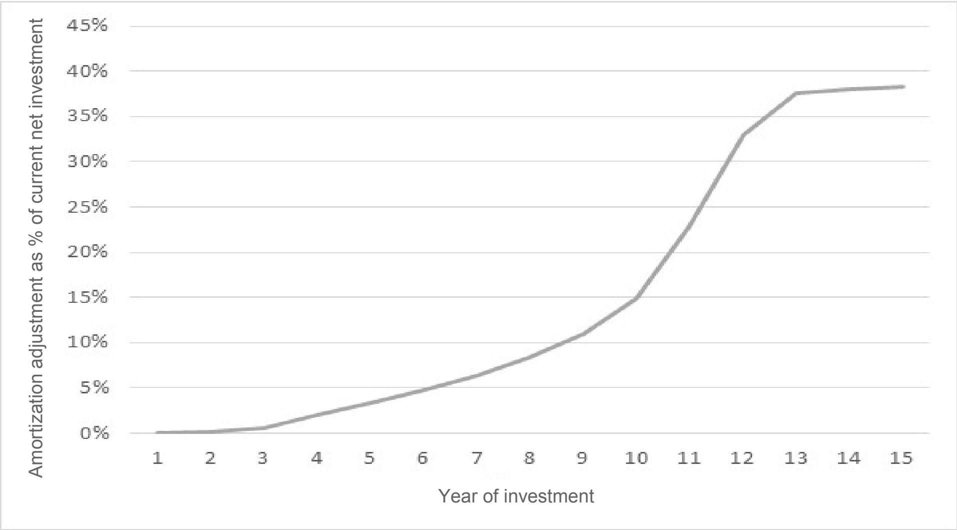
- As shown above, the earnings are identical prior to the tax rate change, after which they drop considerably, resulting in negative earnings in year five due to the amortization catch up adjustment.
- After the amortization adjustment, the earnings normalize, but remain below those in the base case 35% scenario, with the difference becoming more negligible in later years.

Investment amortization adjustment amount in year of tax rate change for sample fund under ASU 2014-01



- The size of the catch up amortization increases as the age of the investment increases up through the end of the tax credit delivery period.
- Investors with seasoned portfolios, particularly those in mid-credit stream, may have significant amortization adjustments due to the change in tax rate.

Investment amortization adjustment amount in year of tax rate change as a % of current net investment for sample fund



- As a percentage of the current carrying value (net of amortization), the one-time adjustment becomes more significant for investments that are later in the holding period since much of the investment has already been written down (though the adjustment amount in dollar terms is a relatively small percentage of your original investment as shown in the previous slide).
- Transactions in the last few years of the compliance period may have significant adjustments as a percentage of the current carrying value.

Conclusion

Impact of tax reform on existing investments

Overall observations

- The decline in the tax rate has a negative impact on yield, with the extent of the impact dependent upon the year of the investment period when the change occurred.
  - Greatest impact on investments in the earlier years of the holding period.
  - Least impact on investments in the later years of the holding period since the majority of the benefits have been recognized at a higher tax rate.
- The GAAP impact on the investment under the ASU 2014-01's proportional amortization method is determined by a two-step process:
  - Test for impairment
    - An impairment charge will occur if the future value of the benefits exceeds the current carrying value and should be reflected above the pretax income line.
  - Calculate the one-time catch-up amortization
    - There would be a one-time adjustment to book value, which would be accounted for in the tax provision section of the financial statements (below the pretax income line).
    - A larger adjustment is required for investments that are further into the investment period.
    - The adjustment amount as a percentage of the carrying value becomes more significant, reaching as high as 40%, for investments that are later in the holding period.
- Under ASU 2014-01's practical expedient method where the investment is amortized based on tax credits only, there would be no changes to the investment amortization when the tax rate changes; however, there would likely be a change to the deferred tax asset/liability associated with the investment.
- Under EITF 94-1 equity method of accounting, the likelihood of an impairment charge is dependent upon how the company has defined tax benefits, and the investment's deferred tax asset/liability would likely be impacted.

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