Lindquist von Husen & Joyce LLP
Certified Public Accountants

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Proactive Planning for Cost Certification Audits

For every new multi-family rental project, regardless if it is a new construction or an acquisition/rehabilitation, in order to receive tax credits, the California Tax Credit Allocation Committee (CTCAC) and/or lender(s) will require a cost certification report (also known as the schedule of sources and uses of funds) audited by a certified public accountant. Just as many other items on a financing checklist, the submission deadline for cost certification reports set by CTCAC and/or lender(s) is quite demanding. Sponsors, on the other hand, can exercise significant influence over how quickly the cost certification audit can be completed.

Based on our experience in working on hundreds of cost certification audits to date, we would like to share our observations and recommended actions so you can be better prepared for your next audit and ensure timely submissions.

1) Streamline Internal Decision-Making and Processes

- Determine if an IRC Section 266 election is necessary to maximize eligible basis for an acquisition/rehabilitation project when filing the initial year partnership tax return.
- Identify a method to allocate the purchase price between land and building, and/or to allocate construction/rehab costs between residential and commercial components.
- Maintain a detailed list of when units are taken out of service for rehabilitation purposes and when they are available for lease again.
- Determine what portion of period costs (e.g., interest, insurance, property taxes) can be capitalized as eligible basis.

2) Seek and Act on Professional Advice

- *When consulting the general contractor:* Properly classify its invoice details to categories including the following:
  - Structure, On-Site Improvements, Off-Site Improvements, General Requirements, Overhead/Profit, Photovoltaic, Furniture and Fixture, etc.
  - For new constructions, pay particular attention to the classification of rough grading and fine grading.
- *When consulting the construction loan lender (if necessary):* Determine how to allocate loan fees or cost of issuance between construction period (basis eligible) and permanent period (non-basis eligible).
- *When consulting attorneys:* Ensure that legal costs have been identified in the following categories:
  - Acquisition, Construction & Permanent Financing
  - Organization & Syndication Costs
- *When consulting the financial adviser:* Understand whether the acquisition loan is subject to the OID provisions of IRC Section 1274, which require the loan principal and purchase price be recast at the AFR rate.

If you have any questions or need assistance with your next cost certification audit, please feel free to contact **Cathy Hwang** at *chwang@lvhj.com*.

Click here to read more about Cathy Hwang.

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