SAN DIEGO HOUSING COMMISSION
SDHC

Real Estate Division

# HOMEBUYER ASSISTANCE PROGRAMS
# MCC INFORMATION PACKET

Congratulations and welcome to the application phase of the MCC program. The San Diego Housing Commission (SDHC) will be processing your MCC application. With the help of your lender, you are applying for a tax credit which will help you purchase your first home and save you thousands of dollars over the coming years in income taxes. To help you understand the MCC, we have put together this package, which your lender is required to give to you when you apply.

Please check to make sure this package is complete. It should contain:
1. MCC Information Summary
2. MCC Example
3. Notice No. 1 Initial Notice to Mortgagor of Potential Recapture Tax
4. Two Recapture Tax Notices

## 1. MCC INFORMATION SUMMARY

### HOW DOES THE MCC WORK?

Upon receiving your MCC, you will become entitled to take a federal income tax credit each year equal to either 15% or 20% of the mortgage interest you paid. Please see the enclosed charts entitled "MCC EXAMPLE". This illustrates how your MCC helps you qualify for your loan, and how it lowers your federal income taxes. By arranging for your employer to withhold less taxes from your pay, you will then realize an increase in your take-home pay, which will help you make your mortgage payment. The MCC is a direct tax credit which you will take in addition to the mortgage interest deduction available to all home owners who make mortgage payments. You will only use the MCC with your federal taxes; state taxes are not affected by it.

### AMOUNT OF TAX CREDIT

SDHC's MCC Program is a two-tiered program. A home buyer will be entitled to take either a **15% or 20%** tax credit which is described as follows:

| Type of MCC | Rate | Description |
|---|---|---|
| Targeted | 20% | Targeted Census Tracts 20% Set-Aside (140% AMI)<br>If you purchase in a targeted census tract with a maximum household income of:<br>1-2 persons: $97,200<br>3+ persons: $113,400<br>...you will be entitled to a **20%** tax credit. |
| Low Income | 20% | One $45,400<br>Two $51,850<br>Three $58,350<br>Four $64,800<br>Five $70,000<br>Six $75,200<br>Seven $80,400<br>Eight $85,550 |
| Non-targeted | 15% | Non-targeted Areas (115% AMI)<br>If you purchase in a non-targeted census tract with a maximum household income of:<br>1-2 persons: $81,000<br>3+ persons: $93,150<br>... you will be entitled to a **15%** tax credit. |

**HOW LONG DOES THE MCC LAST?**
As long as you continue to occupy the property and keep the original financing, you can continue to take the credit for the mortgage interest you paid that year. (An increase in your income after the close of escrow does not affect your eligibility to take the credit.) In a case where the MCC credit exceeds your tax liability for a particular year, you can "roll over" that credit for up to three years. Instructions are on the tax form you will use to take the credit. The following events will cause your MCC to become void: 1) sale or transfer of

**WHO CAN TAKE THE MCC TAX CREDIT?**
Only home purchasers who are issued a mortgage credit certificate from an authorized issuing agency can take the credit. SDHC and the lender who originates your loan will send notification to the IRS that you are entitled to take the credit. Also, you will send a copy of your MCC to the IRS each year in which you claim the credit. If you purchase the property with another taxpayer and you file separate returns, you can share the total amount of the credit in the same proportions that you share interest in the home (but the total must never exceed the 15% or 20% of the interest paid that year).

**APPLICATION FEE**
You have paid a NON-REFUNDABLE fee of $250 if using MCC in conjunction with other SDHC loan programs (i.e. Deferred Second Trust Deed loan and Closing Cost Assistance grant) or .002 of first trust deed loan if applying for MCC <u>only</u> or $250, whichever is greater to SDHC to apply for a MCC. If you are eligible, a MCC will be committed for you for 60 days for the home and loan amount you now seek. It is possible to transfer the MCC to another eligible property during escrow under certain conditions.

**ELIGIBILITY**
Your eligibility will be based on: your gross annual household income which is derived from your current monthly income; your first-time home buyer status, unless you are purchasing in a targeted census tract; and the purchase price of the home. In all cases, the home must be in the City of San Diego limits. After the close of escrow, an increase in your family income will not affect your eligibility to continue to take the credit, but it may affect your recapture tax potential.

**TARGETED CENSUS TRACTS**
If you are purchasing a home in a "targeted census tract", the income and purchase price maximums you qualify under will be higher than that for the non-targeted areas, and the requirement that you be a first-time home buyer is waived. (You will not need tax returns to verify first-time home buyer status.) There are 46 targeted census tracts in the city; they are determined as low-income by the Census Bureau.

**FIRST-TIME HOME BUYER**
For purposes of the MCC program, a first-time home buyer is someone who has not owned a principal residence (a home in which they resided) during the three year period immediately prior to applying for the MCC. We ask to see copies of your tax returns to ensure that you did not take a mortgage interest deduction during that period. You will sign an affidavit claiming first-time home buyer status.

**CANCELLATION**
You, the lender and SDHC are all parties to the commitment SDHC makes to issue you a MCC. SDHC may cancel the MCC if you cease to be eligible, or if the commitment deadline passes without escrow closing and without a written request from your lender for an extension. The lender can not voluntarily cancel your application for a MCC without your permission.

**THE INTERNAL REVENUE SERVICE (IRS)**
This is an IRS program and any documentation you sign during the application process is subject to review by the IRS. It is therefore extremely important that you take the time necessary to read the documents you sign, and to submit only true, accurate, and complete information regarding your taxes and your eligibility. Do not be rushed into signing any of the documents. Feel free to ask what they mean; SDHC's MCC program staff will gladly answer any questions you have about the program.

**YOUR LENDER**
The lender you have chosen to apply to for your mortgage is one of many participating lenders in our program. Your MCC is transferable if you find it necessary during escrow to switch to another participating lender. SDHC has no part in the decision of your lender to approve your loan.

**RECAPTURE TAX**
If you sell or transfer your home within nine years you may be subject to a recapture tax. This package includes information on the recapture tax, including a NOTICE NO. 1 INITIAL NOTICE TO MORTGAGOR OF POTENTIAL RECAPTURE TAX which you signed, and a sample of NOTICE TO MORTGAGOR INFORMATION REGARDING POTENTIAL RECAPTURE TAX which you will receive after the close of escrow. Please read these. If you have questions which your lender is not able to answer please feel free to call SDHC's MCC program staff. It is a rather complicated tax; we will be happy to try to answer your general questions. For information about your specific tax situation you should seek the help of a tax expert. If you experience difficulty finding a tax specialist who understands the MCC, SDHC program staff have a list of professionals who provide MCC tax services.

**REFINANCING**
If you refinance your mortgage, you will lose the MCC (unless you apply for a Reissued MCC). However, refinancing alone will not trigger the recapture tax. Only transfer of the property can trigger the recapture tax.

**COMMITMENT**
After submitting to SDHC your MCC application package, your lender will receive a MCC Commitment indicating SDHC approval. It will be in effect for 60 days. **If at the expiration of the 60 days the lender has not submitted the required documentation, the original Commitment will expire and the lender will be charged a fine of $175 to extend or cancel the application. This fine is not to be passed on to you.**

**WHAT HAPPENS NEXT?**
You will execute various MCC documents and provide copies of your three most recent years' tax returns. Be sure to sign and date them in blue ink. If copies of your tax returns are not available, your lender will tell you how you can still meet the requirement. At the close of escrow you will sign a CLOSING AFFIDAVIT stating that nothing happened during escrow to make you ineligible for the MCC (such as a pay raise). After escrow closing, **and after we have received the closing documentation from your lender (see "Commitment" above),** we will send you a package containing your Mortgage Credit Certificate and other documents including a tax memorandum explaining how to use your MCC.

EQUAL HOUSING OPPORTUNITY

## 2. MCC EXAMPLE SHEET

Here is how the *Robert J. Buyer family* can benefit from purchasing a home under the Mortgage Credit Certificate Program.

| | |
|---|---|
| Family Income: | $2,500 per month |
| Loan Amount: | $100,000 |
| Interest Rate: | 8% |

1. Determine the First Year Interest Payment — $100,000 x .08 = **$8,000**
2. Determine the Annual Mortgage Credit — $8,000 x .20 = **$1,600**
   (First Year Interest Payment x 20% MCC Credit Rate)
3. Determine Monthly Mortgage Credit — $1,600 ÷ 12 = **$133.33**
   (Annual Mortgage Credit ÷ 12 months)

**Four Steps to Tax Savings**

The Buyer family income is $2,500 per month, earned through Mr. Buyer's employment. This illustration shows how Mr. Buyer's take-home pay will be increased with the help of a mortgage credit equal to approximately $133 per month.

1. Without MCC

$2,500 mo. earnings
– 500 withheld taxes
$2,000 take home pay

Annual Tax Debt Withheld
$6,000 $6,000 ($500 x 12)

1. Without MCC: worker earns $2,500/mo. and nets $2,000/mo.

***because***

$6,000/yr, or $500/mo, is withheld & owed in taxes

2. Tax Credit Received under MCC Program

$1,600 per year or
$ 133 per month

2–3. Worker buys a home & receives MCC from the San Diego Housing Commission giving worker a tax credit of:

$1,600/yr or $133/mo.

Worker's tax debt is reduced to: $4,400/yr, or $367/mo.
Worker instructs employer to withhold only $367/mo.

3. New Estimated Annual Taxes

$6,000 Annual Tax Debt
–1,600 MCC Annual Credit
$4,400 New Annual Tax Debt
($4,400 ÷ 12 = $367/mo)

4. With MCC, worker earns $2,500/mo. & nets $2,133/mo.

***because***

Now only $4,400/yr, or $367/mo, is withheld & owed in taxes.

4. With MCC

$2,500 mo. earnings
– 367 withheld taxes
$2,133 take home pay

Annual Tax Debt Withheld
$4,400 $4,400

## 3. NOTICE NO. 1 INITIAL NOTICE TO MORTGAGOR OF POTENTIAL RECAPTURE TAX

**SAN DIEGO HOUSING COMMISSION**
**Loan Management Division**
**1122 Broadway, Suite 300**
**San Diego, California 92101**
**619.578.7490**

**MCC No.:** ____________________

**Name of Applicant:** ____________________

**Social Security No.:** ____________________

**Name of Co-Applicant:** ____________________

**Social Security No.:**

# NOTICE TO MORTGAGOR
# INFORMATION REGARDING POTENTIAL RECAPTURE TAX

(to be delivered to Mortgagor at or before closing for all closings on or after January 1, 1991)



Because you have received a Single Family Bond Loan (Mortgage Credit Certificate), pursuant to Section 143(m) of the Internal Revenue Code of 1986 (the "Code"), you may, at the time you sell the residence for which you received a Single Family Bond Loan (Mortgage Credit Certificate), be subject to a special "recapture tax" for federal income tax purposes. You should consult your tax advisor at the time you sell the residence to determine the amount, if any, of such **"recapture tax."** The following information will assist you in determining the amount, if any of **"recapture tax":**

1. Name or Mortgagor(s): ____________________
   ____________________
   ____________________
   ____________________
2. Location of Home: ____________________
3. Principal amount of Home Mortgage on date of Mortgage Closing: _____________
4. Date of Home Mortgage Closing:________
5. Is the Home in an IRS Targeted area:_____

## ARE YOU SUBJECT TO THE RECAPTURE TAX?

You will be subject to a special recapture tax for the tax year in which you sell or transfer your home only if you meet all four of the following conditions:

1. You sell or transfer the home on or before ___________ (9 years from the date of Mortgage Closing listed above), and

2. You sell or transfer the home at a gain (determined by the IRS form on gain from sale of a single-family residence, whether or not you decide to rollover the gain), and

3. The Home is not:
   a. transferred as a result of death,
   b. transferred to a former spouse as a result of divorce (in which case the former spouse is treated as if he or she has been the owner from the date of date of Mortgage Closing), or
   c. rebuilt from casualty insurance proceeds within two years after its destruction; and

4. Your taxable household income for the year in which you sell your home exceeds the following Income Threshold.

**TABLE I**

| This income chart is applicable for your home which: | INCOME THRESHOLD<br>Number of members of the Mortgagor's Household at the time of resale of the Home |
|---|---|

☐ is ☒ is not
In a targeted census tract.

| | 1 or 2 persons Current Threshold | 3 or more persons Current Threshold |
|---|---|---|
| Sell before: | $74,900 | $86,135 |
| 1 year after Mortgage Closing: | $78,645 | $90,442 |
| 1 or more years, but less than 2 years after Mortgage Closing: | $82,577 | $94,964 |
| 2 or more years, but less than 3 years after Mortgage Closing: | $86,706 | $99,712 |
| 3 or more years, but less than 4 years after Mortgage Closing: | $91,041 | $104,698 |
| 4 or more years, but less than 5 years after Mortgage Closing: | $95,593 | $112,933 |
| 5 or more years, but less than 6 years after Mortgage Closing: | $100,373 | $118,580 |
| 6 or more years, but less than 7 years after Mortgage Closing: | $105,392 | $124,510 |
| 7 or more years, but less than 8 years after Mortgage Closing: | $110,662 | $130,736 |
| 8 or more years, but less than 9 years after Mortgage Closing: | $116,195 | $137,273 |

Your taxable income is the "adjusted gross income" from your tax return for the year in which you sell your home plus any tax exempt bond interest income you may have. (However, do not include any gain from the sale of the home itself in determining whether you are above the Income Threshold listed above.)

## HOW MUCH RECAPTURE TAX WOULD YOU OWE?

If you meet all four of the above conditions, then you will be subject to the recapture tax.
The amount of the recapture tax is the lesser of:

- the maximum potential recapture tax (calculated under Steps 1 and 2 below),
- One-half of your gain from the sale of the home (see page 3).

The recapture tax will **never** exceed .0625 (6¼%) of the principal loan amount at origination. Several factors can significantly decrease that maximum, as illustrated in the steps below. For the formula on which these steps are based, see "*Note" at the end of this section.

### Maximum Potential Recapture Tax

The maximum potential recapture tax (MPRT) you will owe is calculated in **two steps**:

**STEP 1**

See the line on the left which best describes the date of transfer of the home. The corresponding line on the right gives applicable maximum potential recapture tax (MPRT).

**TABLE II**

| Date of Sale or Transfer of Home (or Prepayment of Mortgage if Earlier) | MPRT (MAXIMUM POTENTIAL RECAPTURE TAX) Percentage of Original Mortgage | Dollar Amount Based on Original Mortgage of: $100,000.00 |
|---|---|---|
| Before: | | |
| 1 year after Mortgage Closing: | 1.25% | $1,250.00 |
| 1 or more years, but less than 2 years after Mortgage Closing: | 2.50% | $2,500.00 |
| 2 or more years, but less than 3 years after Mortgage Closing: | 3.75% | $3,750.00 |
| 3 or more years, but less than 4 years after Mortgage Closing: | 5.00% | $5,000.00 |

**TABLE I**

This income chart is applicable for your home which:

☒ is ☐ is not

in a targeted census tract.

| | INCOME THRESHOLD<br>Number of members of the Mortgagor's Household<br>at the time of resale of the Home | |
|---|---|---|
| | 1 or 2 persons<br>Current Threshold | 3 or more persons<br>Current Threshold |
| Sell before: | $89,880 | $104,860 |
| 1 year after Mortgage Closing: | $94,374 | $110,103 |
| 1 or more years, but less than 2 years after Mortgage Closing: | $99,093 | $115,608 |
| 2 or more years, but less than 3 years after Mortgage Closing: | $104,048 | $121,388 |
| 3 or more years, but less than 4 years after Mortgage Closing: | $109,250 | $127,457 |
| 4 or more years, but less than 5 years after Mortgage Closing: | $114,713 | $133,830 |
| 5 or more years, but less than 6 years after Mortgage Closing: | $120,449 | $140,522 |
| 6 or more years, but less than 7 years after Mortgage Closing: | $126,471 | $147,548 |
| 7 or more years, but less than 8 years after Mortgage Closing: | $132,795 | $154,925 |
| 8 or more years, but less than 9 years after Mortgage Closing: | $139,432 | $162,671 |

Your taxable income is the "adjusted gross income" from your tax return for the year in which you sell your home plus any tax exempt bond interest income you may have. (However, do not include any gain from the sale of the home itself in determining whether you are above the Income Threshold listed above.)

## HOW MUCH RECAPTURE TAX WOULD YOU OWE?

If you meet all four of the above conditions, then you will be subject to the recapture tax.
The amount of the recapture tax is the lesser of:

- the maximum potential recapture tax (calculated under Steps 1 and 2 below),
- One-half of your gain from the sale of the home (see page 3).

The recapture tax will **never** exceed .0625 (6¼%) of the principal loan amount at origination. Several factors can significantly decrease that maximum, as illustrated in the steps below. For the formula on which these steps are based, see "*Note" at the end of this section.

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**STEP 1**

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**TABLE II**

| | MPRT (MAXIMUM POTENTIAL RECAPTURE TAX) | |
|---|---|---|
| Date of Sale or Transfer of Home<br>(or Prepayment of Mortgage if Earlier) | Percentage of Original Mortgage | Dollar Amount Based on Original Mortgage of: $100,000.00 |
| Before: | | |
| 1 year after Mortgage Closing: | 1.25% | $1,250.00 |
| 1 or more years, but less than 2 years after Mortgage Closing: | 2.50% | $2,500.00 |
| 2 or more years, but less than 3 years after Mortgage Closing: | 3.75% | $3,750.00 |
| 3 or more years, but less than 4 years after Mortgage Closing: | 5.00% | $5,000.00 |

| | | |
|---|---|---|
| 4 or more years, but less than 5 years after Mortgage Closing: | 6.25% | $6,250.00 |
| 5 or more years, but less than 6 years after Mortgage Closing: | 5.00% | $5,000.00 |
| 6 or more years, but less than 7 years after Mortgage Closing: | 3.75% | $3,750.00 |
| 7 or more years, but less than 8 years after Mortgage Closing: | 2.50% | $2,500.00 |
| 8 or more years, but less than 9 years after Mortgage Closing: | 1.25% | $1,250.00 |

**Example:** If the home was sold between 1 and 2 years after Mortgage Closing, use 2.5% of original mortgage. Thus, if original mortgage was $100,000, the maximum potential recapture tax would be $2,500 ($100,000 x 2.5%).

## STEP 2

**Possible Reduction of Recapture Tax**

Determine whether your taxable income, in the year in which you sell the home, exceeds the Income Threshold shown in Table I, and if it does whether such excess is more or less than $5,000 above the Income Threshold shown in Table I.

**Example:** If you have a 2 person household at the time of sale and your income is $53,000, and the Income Threshold in Table I for that year is $50,000, your "excess income" is $3,000:

| | |
|---|---|
| Actual Household Income | $62,745 |
| - Income Limit (From Table I) | $59,745 |
| Excess Income above Income Threshold | $ 3,000 |

You will be in one of three situations:

(i) Your income does not exceed the Income Threshold:
You are not subject to any recapture tax at all.

(ii) Your income is more than $5,000 above the Income Threshold:
There is no reduction in the maximum potential recapture tax calculated in Step 1.

(iii) Your income is less than $5,000 above the Income Threshold:
Your maximum potential recapture tax will be reduced pro rata, as shown below:

If your excess income is less than $5,000 above the Income Threshold, the revised maximum potential recapture tax would be:

$$\text{Revised Maximum Potential Recapture Tax} = \frac{\text{Excess Income (From Step 2)}}{\$5{,}000} \times \text{MPRT (from Table II)}$$

**Example:** $\dfrac{\text{Actual Income - Income Threshold}}{\$5{,}000} = \dfrac{\$3{,}000}{\$5{,}000} = 60\% \times 2{,}500$ MPRT (from Table II)

= $1,500 **Revised** Maximum Potential Recapture Tax

Thus, the maximum potential recapture tax of $2,500 determined in Step 1 would be reduced to $1,500 due to the calculation in Step 2.

***NOTE:** These instructions are meant to provide a step by step process for figuring a potential recapture tax. The legislative formula on which these steps are based is:

$$PRT = 6.25\% \times P \times H \times \frac{M - (IL \times 1.05^{Y})}{5000}$$

PRT = Potential Recapture Tax
P = original principal amount
M = mortgagor's adjusted gross income at time of sale
IL = original income limit

H = holding period percentage Y = number of complete years mortgagor owned home

NOTE: If "$M - (IL \times 1.05^{Y})$" is greater than $5,000, that amount is treated as equal to $5,000.

## Gain on Sale of Home:

Finally, compare the revised maximum potential recapture tax (from Step 2) to one-half of your actual gain from the sale of the home. (Your "Gain" is generally defined by the IRS to be the resale price less: (i) sale costs, (ii) your original purchase price, and (iii) your cost of capital improvements. This is true whether or not you rollover the gain.) You pay whichever is less.

- Revised Maximum Potential Recapture Tax = $1,500
- Gain from Sale of Home

| | | |
|---|---|---|
| Sale Price | $150,000 | |
| - Closing Costs | $ 8,000 | |
| | $142,000 | |
| - Basis in Home | $130,000 | ($120,000 initial price plus $10,000 cost of improvements) |
| Gain | $ 12,000 | |
| x 1/2 = | $ 6,000 | |

- Lesser of $1,500 and $6,000 is $1,500; so $1,500 is the Recapture Tax.

**Other Factors Affecting the Recapture Tax**

All references to the "sale" or "transfer" of the home include any change in your interest in the Home, whether by sale, exchange, gift or some other disposition.

If any person other than you or your spouse is also a mortgagor, each person's Recapture Tax will be determined separately in accordance with his or her interest in the home.

The Recapture Tax may also be somewhat reduced if you prepay the mortgage in whole (e.g. refinance) and do not sell the home until a subsequent year.

The Recapture Notice is provided by the San Diego Housing Commission (Issuer) pursuant to Section 143 (m) (7) of the Code.