

## Understanding LIHTC Internal Rate of Return/Yield

The **Internal Rate of Return (IRR)** is a financial metric used to evaluate the profitability of an investment. It represents the discount rate at which the net present value (NPV) of all cash flows (both incoming and outgoing) from the investment equals zero. In simpler terms, **IRR is the rate of growth an investor can expect to earn** on their invested capital.

### Why IRR Matters to a LIHTC Investor

IRR is a crucial tool for investors because it allows them to:

- ▶ **Compare** the profitability of different investments.
- ▶ **Understand** the time value of money
- ▶ **Assess** whether an investment meets their required thresholds.

For LIHTC projects, IRR helps investors determine whether the combination of tax credits, potential losses, distributable cash, and equity contributions makes the investment worthwhile.



IRR helps investors compare profitability of various LIHTC investments.

### How to Calculate IRR



#### RESOURCE

[Click here](#) to download **AHIC's Investor Benefit Schedule**, an interactive spreadsheet tool to reference as you review the rest of this document. Alternately, use the QR code to open or access it at [bit.ly/ahic-benefits-schedule](https://bit.ly/ahic-benefits-schedule).



**IRR calculations involve solving for the discount rate that sets the NPV of an investment's cash flows to zero.** While this can be done manually using iterative methods, financial software and spreadsheets are typically used to simplify the process.

**There are multiple ways to calculate IRR.** If using the simple IRR function, you are assuming equal time periods between each cell. This becomes challenging when figuring for the actual timing of capital calls. Use of the Extended IRR or "XIRR" function provides flexibility with time periods of capital calls and cash flows.

# Understanding the Investor Benefit Schedule

Investors determine their IRR or Yield (as its commonly referred to in our industry) by reviewing benefit schedules, the key components of which include:



**Timing of Capital** (gross equity) paid into the deal or fund. Capital contributions are sometimes paid into the project according to an agreed upon schedule between the investor and the developer or syndicator. The capital call schedules are dictated by the capital needs of the underlying projects and the pay down of bridge loan facilities utilized by the syndicators to smooth out capital calls and generate increased returns to the investors. Generally, the later the equity is paid in to the project, the higher the IRR.



**Price per credit.** Generally, the lower the price per credit, the higher the IRR.



**Projected Tax Losses** also affect IRR. Projected losses flow to the investor by design. While a tax credit directly offsets an investor's tax liability, the tax losses reduce the investor's annual taxable income, which lowers their effective tax rate. Given the tax losses have value to the investor, the losses generated from lower tier debt can also boost IRR. In addition, depreciation and accelerated depreciation can affect the investment's IRR positively. Notably, 100% bonus depreciation was made permanent in 2025, creating an opportunity for yield boost.



**Upper Tier Fees** or load include fees paid to the syndicator, upper tier reserves and ongoing asset management fees. The lower these fees and the later they are paid, the higher the IRR.



Later capital contributions generally improve returns, but capital timing must align with project needs and bridge financing strategies.



Most institutional investors value tax credits above losses – and do not pay additional value for losses in pricing.

## Benefits Back to the Investor

**Tax Credits.** The majority of return is generated by the tax credits which is determined by eligible basis calculations and/or credit allocation. Tax credits are generally claimed by the investor over a 10-year period.

**Taxable Losses.** Losses are generated from project operations which include operating expenses, debt service, and depreciation (including bonus depreciation taken in the first year of the investment). **Losses are tax-deductible, which is a source of income tax deduction for investors.** Losses on 4% transactions tend to generate a larger portion of the investors' yield than losses on 9% transactions because they are structured with more debt than 9% transactions and, thus, have higher tax-deductible interest expenses.

- ▶ Some investors look at the loss ratio: total losses/gross equity.
- ▶ Some investors will limit or cap the amount of losses that may be used for purposes of calculating IRR.
- ▶ Some investors cannot utilize capital losses at the end of an investment and will not factor those into their project IRR.
- ▶ Most investors value credits above losses and do not pay for losses.

**Cash Flow/Distributions.** Some investments generate cash flow to the investor.

**Capital Gains/Losses.** Depending upon the state of the capital account at exit, the investor may be faced with a capital gain or loss. If losses exceed capital contributed, the investor will have a capital gain (a taxable event). If contributions exceed losses, the investor will have a loss. Either instance is projected in the investor benefits schedule at the end of the 15-year compliance period recognizing the dissolution of the fund.



Credits follow losses, so projected losses flow to investors by design, lowering taxable income and improving after-tax yield – particularly in 4% transactions.



At Exit

**Losses > Contributions =  
Capital Gain**

**Contributions > Losses =  
Capital Loss**



### NEXT STEPS

Learn more about LIHTC program from the investor's perspective with AHIC's suite of underwriting and asset management best practices at [bit.ly/LIHTCKnowledge](https://bit.ly/LIHTCKnowledge).

**About the Series:** AHIC's LIHTC Decoded series helps educate industry participants and stakeholders about the investor's perspective of this public-private partnership.



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