Low Income Housing Tax Credit Program

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Administering Agency: Internal Revenue Service (IRS) of the Department of the Treasury
Year program started: 1986
Number of households served: 53,048 in 2011, the latest data available
Population targeted: Households with incomes either below 80% of area median income (AMI) or 50% AMI
FY13 funding: Joint Committee on Taxation estimates $5.9 billion for 2013; 2014 estimates not available at press time
See also: *Qualified Allocation Plan*

The Low Income Housing Tax Credit program (LIHTC) finances the construction, rehabilitation, and preservation of housing affordable to lower income households. The LIHTC program encourages private investment by providing a tax credit: a dollar-for-dollar reduction in federal taxes owed on other income. Although housing tax credits are federal, each state has an independent agency that decides how to allocate the state's share of federal housing tax credits within a framework formed by the Internal Revenue Code.

HISTORY

LIHTC was created by the Tax Reform Act of 1986 and is codified at Section 42 of the Internal Revenue Code, 26 U.S.C. 42, so tax credit projects are sometimes referred to as Section 42 projects. The IRS provides additional guidance through revenue rulings, technical advice memorandums, notices, private letter rulings, and other means.

PROGRAM SUMMARY

The LIHTC program finances the construction, rehabilitation, and preservation of housing affordable to lower income households. LIHTC can be used to support a variety of projects: multifamily or single-family housing; new construction or rehabilitation; special needs housing for elderly people or people with disabilities; and permanent supportive housing for homeless families and individuals. The latest data from HUD indicates that LIHTC has provided more than 2.3 million rental units between 1987 and 2011.

LIHTC is designed to encourage private individuals and corporations to invest cash in housing affordable to lower income people by providing a tax credit over a 10-year period: a dollar-for-dollar reduction in federal taxes owed on other income. The cash investors put up, called equity, is used along with other resources to build new affordable housing or to make substantial repairs to existing affordable housing. Tax credits are not meant to provide 100% financing. The infusion of equity reduces the amount of money a developer has to borrow and pay interest on, thereby reducing the level of rent that needs to be charged.

The Furman Center for Real Estate and Urban Policy at New York University released a report in October 2012 using tenant-level data from 15 states representing 30% of all LIHTC units. The report found that LIHTC recipients tend to have higher incomes than households assisted by other federal rental assistance programs, but that 43% of the households were extremely low income, with incomes below 30% AMI. However, 69% of those extremely low income households also had other forms of rental assistance, such as vouchers. For the 31% of extremely low income LIHTC households who do not have rental assistance, more than half pay more than 50% of their income for rent, have "severe cost burden."

Although housing tax credits are federal, each state has an independent agency, generally called a housing finance agency, or HFA, that decides how to allocate the state's share of federal housing tax credits. Tax credits are allocated to states based on population. For 2014, each state received $2.30 per capita, with small states receiving a minimum of $2.635 million.

Each HFA must have a qualified allocation plan (QAP), which sets out the state's priorities and eligibility criteria for awarding federal tax credits, as well as tax-exempt bonds and any state-level tax credits, to housing projects. Developers apply to an HFA and compete for tax credit allocations. The law requires that a minimum of 10% of an HFA's total tax credits be set aside for nonprofits.

Once awarded tax credits, a developer then sells them to investors, usually to a group of investors pulled together by someone called a syndicator. Syndicators sometimes pool several tax credit projects together and sell investors shares in the pool. The equity that the investors provide is used by the developer, along with other resources such as conventional mortgages, state loans, and funds from the HOME program to construct or substantially rehabilitate affordable housing.

When applying to an HFA for tax credits, a developer has two lower income unit set-aside options, and must stick with the chosen option during a required lower income occupancy period. The two lower income unit set-aside choices are:

- Ensuring that at least 20% of the units are rent-restricted and occupied by households with income below 50% of area median income (AMI).
- Ensuring that at least 40% of the units are rent-restricted and occupied by households with income below 60% AMI.

Rent-restricted units have fixed maximum gross rents, including allowance for utilities, that are less than the rent charged to a hypothetical tenant paying 30% of either 50% AMI or 60% AMI, whichever option the developer chose. Tenants may have to pay rent up to that fixed maximum tax credit rent even if it is greater than 30% of their income. In other words, the maximum rent a tenant pays is not based on 30% of the tenant's income; rather it is based on 30% of the fixed AMI level (50% or 60%).

Consequently, lower income residents of tax credit projects might be rent burdened, meaning they pay more than 30% of their income for rent and utilities. Or, tax credit projects might simply not be financially available to very low and extremely low income people because rents charged are not affordable to them. HUD's tenant-based or project-based vouchers or USDA Rural Development Section 521 Rental Assistance are often needed to fill the gap between 30% of a resident's actual income and the tax credit rent.

Tax credits are available only for rental units that meet one of the above rent-restricted minimums (20/50 or 40/60). With these minimums it is possible for LIHTC projects to have a mix of units occupied by lower income people and moderate and middle income people. These are minimums; projects can have higher percentages of rent-restricted units occupied by lower income people. In fact, the more rent-restricted lower income units in a project the greater the amount of tax credits provided. Some HFAs choose to create deeper targeting in order to serve households with even lower incomes.

The law requires units to be rent-restricted and occupied by income-eligible households for at least 15 years, called the compliance period, with an extended use period of at least another 15 years, for a total of 30 years. Some states require low income housing commitments greater than 30 years or provide incentives for projects that voluntarily agree to longer commitments. Where states do not mandate longer restricted-use periods, an owner can submit a request to the HFA to sell a project or convert it to market rate during year 14 of the 15-year compliance period. The HFA then has one year to find a buyer willing to maintain the rent restrictions for the balance of the 30-year period. If the property cannot be sold to such a preservation purchaser, then the owner's obligation to maintain rent-restricted units is removed and lower income tenants receive enhanced vouchers enabling them to remain in their units for three years.

HFAs must monitor projects for compliance with the income and rent restriction requirements. The IRS can recapture tax credits if a project fails to comply, or if there are housing code or fair housing violations.

There are two levels of tax credit, 9% and 4%, formally known as the applicable percentages. Projects can combine 9% and 4% tax credits. For example, buildings can be bought with 4% tax credits and then substantially rehabilitated with 9% tax credits. Instead of 9% and 4%, tax credits are sometimes referred to by the net present value they are intended to yield, either 70% or 30%. This is just another way of saying, in the case of a 9% credit, that the stream of tax credits over the 10-year credit period has a value today equal to 70% of the eligible development costs.

The 9% tax credit is available for new construction and substantial rehabilitation projects that do not have other federal funds. Federal funds include loans and bonds with below market-rate interest. Rehabilitation is substantial if the greater of an average of $3,000 is spent on each rent-restricted lower income unit or 10% is spent on the eligible basis during a 24-month period.

The 4% tax credit is available for three types of activities:

- Acquisition of existing buildings for substantial rehabilitation;
- New construction or substantial rehabilitation subsidized with other federal funds; and,
- Projects financed with tax-exempt bonds. (Every year, states are allowed to issue a set amount, known as the volume cap, of tax-exempt bonds for a variety of economic development purposes.)

The figures 9% and 4% were only approximate rates. IRS computed actual rates monthly based on Treasury Department interest rates, the applicable percentage. For any given project, the real tax credit rate was set the month a binding commitment was made between an HFA and developer, or the month a finished project was first occupied, placed in service. This applicable percentage is applied to the 'qualified basis' to determine the investors' tax credit each year for 10 years (the credit period). However, for 9% projects, the Housing and Economic Recovery Act of 2008 (HERA) established a fixed 9% value for projects placed in service between July 30, 2008 and January 1, 2014. The American Taxpayer Relief Act of 2012 allowed any project receiving a LIHTC allocation before January 1, 2014 to qualify for the fixed 9% credit. Because there was no Congressional action in 2013 to set a fixed the 9% value, the applicable percentage for March 2014 is 7.60%. The 4% credit continues to float, with an applicable rate of 3.26% in March 2014.

The amount of tax credit a project can receive, and therefore how much equity it can attract, depends on a several factors. First, the eligible basis must be determined by considering cost such as building acquisition, construction, soil tests, engineering costs, and utility hookups. Land acquisition and permanent financing costs are not counted toward the eligible basis. The eligible basis is usually reduced by the amount of any federal funds. The eligible basis of a project can get a 30% increase, or basis boost, if the project is located in a census tract designated by HUD as a low income tract (Qualified Census Tract, or QCT) or a high-cost area (Difficult to Develop Area, or DDA). HERA expanded the use of this basis boost to areas designated by a state as requiring an increase in the credit amount in order to be financially feasible.

Next, the applicable fraction must be determined. This is a measure of rent-restricted lower income units in a project. There are two possible percentages: the ratio of lower income units to all units (the unit fraction), or the ratio of square feet in the lower income units to the project's total square feet (the floor space fraction). The lowest percentage is the applicable fraction. The applicable fraction agreed to by the developer and IRS at the time a building is first occupied is the minimum that must be maintained during the entire affordability period.

The qualified basis is the eligible basis multiplied by the applicable fraction. The amount of annual tax credits a project can get is the qualified basis multiplied by the tax credit rate (9% or 4%).

FUNDING

The LIHTC is a tax expenditure, which does not require an appropriation. The Joint Committee on Taxation estimated that the program would cost $5.9 billion in tax expenditures in 2013. The committee's 2014 estimates are not available as of March 27, 2014.

FORECAST FOR 2014

Chief issues of concern for the LIHTC program last year, tax reform and deficit reduction, have diminished for the time being. Several advisory commissions in previous years recommended either the elimination of or a substantial reduction in tax expenditures. In 2012 there was strong bipartisan support in both the House and the Senate for lowering statutory corporate tax rates. However, as 2013 drew to a close, the likelihood of tax reform diminished for two reasons. First, a proponent of major tax reform and Chair of the Senate Finance Committee, Senator Max Baucus (D-MT), was confirmed to be the next U.S. ambassador to China, disrupting momentum for tax reform. Second, House Ways and Means Committee Chair Dave Camp (R-MI) encountered reluctance from House leadership because of the divisive nature of tax reform. Because the LIHTC is one of the largest corporate tax expenditures, it remains vulnerable to future elimination or substantial reduction to help pay for the lowered rates.

Some advocates continue to seek to permanently set the 9% credit at that level rather than the lower floating rate that took effect when the HERA and American Taxpayer Relief Act of 2012 fixed 9% provisions expired on January 1, 2014. In addition advocates want to establish a fixed rate for 4% credits. On August 1, 2013, Senator Maria Cantwell (D-WA) introduced S. 1442, which would achieve these aims.

On March 15, 2013, Representative Keith Ellison (D-MN) introduced H.R. 1213, a bill to reform the mortgage interest deduction by changing it to a 15% nonrefundable tax credit and lowering the maximum mortgage amount eligible for a tax break from $1 million to $500,000. Such reform is estimated to both make the tax break available to 16 million more households and save the federal government $196 billion over ten years. Mr. Ellison proposed to dedicate 60% of the savings to the National Housing Trust Fund. In addition, Mr. Ellison's bill proposes significant LIHTC provisions. Before determining the 60% in federal savings for the National Housing Trust Fund, the LIHTC per capita allocation would be raised to $2.70 and increased annually by a cost-of-living index. The $2 million minimum allocation for small states would also be increased by an annual cost-of-living adjustment. Most importantly, the LIHTC program would create an incentive to develop units affordable to extremely low income people by providing a 150% basis boost.

The President's budget request for FY15 contains six proposed changes to the LIHTC program:

1. As in previous years, Treasury is proposing an "income-mixing" provision that would add a third rent-restricted category (in addition to the 20/50 and 40/60 options). That option would require that at least 40% of the units in a project to be occupied by households with incomes averaging 60% of AMI, allowing LIHTC units to serve households with income up to 80% AMI. Proponents of this provision think it will provide an incentive to include some units targeted to extremely low income households in a project's mix. For purposes of computing the average, the proposal would treat any unit with an income limit below 20% of AMI as if it were at 20% AMI, a feature that would be a disincentive to provide housing for individuals with Supplemental Security Income (SSI)-level incomes, which is 13.5% of the 2014 national median income for an individual (20% for a couple).
2. Rather than extend the 9% credit floor, the Administration proposes revising the formula to more closely reflects the cost of borrowing when interest rates are very low or very high. The proposed new discount rate would be the average of the mid-term and long-term applicable federal rates, plus 200 basis points.
3. In order to make more LIHTC available to states, the Administration proposes allowing states to convert up to 8% of their private activity bond cap to LIHTCs. For each $1,000 of private activity bond cap foregone, a state would receive additional LIHTC authority amounting to $1,000 x twice the applicable percentage for 4% bond-financed LIHTCs. The Administration explains that 4% credits sometimes do not provide adequate equity for some projects, and that the transaction costs of issuing bonds can be a significant economic impediment to financing smaller projects.
4. Because preservation and rehabilitation of existing properties is often more efficient, the Administration proposes adding preservation of federally assisted affordable housing to the current list of ten selection criteria that every QAP must include.

5. The Administration proposes providing protections similar to those in the Violence Against Women Act (VAWA) for both low income and market-rate units.
6. Finally, the Administration proposes allowing a Real Estate Investment Trust (REIT) to designate as tax exempt some of the dividends it distributes.

On February 26, 2014, the House Ways and Means Chair, David Camp (R-MI), proposed LIHTC changes in his Tax Reform Act of 2014, including:

- Eliminating 4% credits and private activity bonds;
- Changing the length of the tax credit period to 15 years from 10 years;
- Eliminating the 130% basis boost for QCTs and DDAs; and,
- Removing energy efficiency and historic nature of a property from the list of ten required selection criteria in QAPs.

NLIHC and other advocates are seeking to modify the program to deepen the income targeting and modify the rent structure in order to reduce potential rents burdens on extremely low and very low income tenants.

TIPS FOR LOCAL SUCCESS

Low Income Housing Tax Credits are distributed based on a state's Qualified Allocation Plan. See the QAP chapter for advocacy ideas for influencing how LIHTC is used in your state.

WHAT TO SAY TO LEGISLATORS

LIHTC is an important source of funding for affordable housing. Congress should act to protect the program and provide a means to target more units that are affordable to extremely low income residents paying no more than 30% of their income for rent and utilities.

FOR MORE INFORMATION

- National Low Income Housing Coalition, 202-662-1530, www.nlihc.org
- Affordable Rental Housing A.C.T.I.O.N. Campaign, http://rentalhousingaction.org
- HUD training material about LIHTC, www.hud.gov/offices/cpd/affordablehousing/training/web/lihtc
- HUD's database of LIHTC projects, updated through 2011, www.huduser.org/datasets/lihtc.html
- List of QCTs and DDAs, www.huduser.org/datasets/qct.html
- Novogradac, a consulting firm, lists the HFAs in all states, http://bit.ly/XoOL2b