

# Low-Income Housing Tax Credits

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**Administering Agency:** Internal Revenue Service (IRS) of the Department of the Treasury

**Year Started:** 1986

**Number of Households Served:** 44,153 lower-income households in 2016, the latest data available

**Population Targeted:** Households with income either less than 60% of area median income (AMI) or 50% AMI

**Funding:** FY19 is \$9 billion

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 the LIHTC program is federal, each state has an independent agency, generally called a housing finance agency (HFA) that decides how to allocate the state's share of federal housing tax credits within a framework formed by the Internal Revenue Code.

## HISTORY

The LIHTC program 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. Although the LIHTC program is federal, each state has an independent housing finance agency (HFA) that decides how to allocate the state's share of LIHTC, which is based on each state's population.

LIHTC is designed to encourage corporations and private individuals to invest cash in housing affordable to lower-income people; those with income less than 60% of area median income (AMI) or 50% AMI. LIHTC provides this encouragement by providing a tax credit to the investor over the course of a 10-year “credit period”: a dollar-for-dollar reduction in federal taxes owed on other income. The cash that investors put up, called equity, is used along with other resources such as HOME Investment Partnerships or the national Housing Trust Fund (HTF) to build new affordable housing or to make substantial repairs to existing affordable housing. LIHTC is 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 rent level that needs to be charged.

A report by researchers from the Furman Center for Real Estate and Urban Policy at New York University was published in *Housing Policy Debate* in May 2013. The researchers used tenant-level data from 18 states representing 40% of all LIHTC units. The report found that LIHTC recipients tend to have higher incomes than households assisted by other federal rental assistance programs. Although 45% of the households had income less than 30% AMI, were “extremely low income” (ELI), approximately 70% of those ELI households also had other forms of rental assistance, such as vouchers. For the 30% of ELI LIHTC households who did not have rental assistance, 86% paid more than

30% of their income for rent and utilities and therefore suffered a “cost burden;” 58% endured “severe cost burden,” paying more than 50% of their income for rent and utilities.

## PROGRAM BENEFICIARIES

### LIHTC Units

Until 2018, when applying to an HFA for tax credits, a developer had two lower-income unit set-aside options and had to stick with the chosen option during a required lower-income occupancy period. Income averaging was introduced for 2018 by the “Consolidated Appropriations Act of 2018.”

The traditional 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 less than 50% of AMI.
- Ensuring that at least 40% of the units are rent-restricted and occupied by households with income less than 60% of AMI.

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 people of lower, moderate, and middle incomes. 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. New developments should balance considerations of the need for more units with the value of mixed-income developments and with concerns about undue concentrations of poverty in certain neighborhoods.

The FY18 appropriations act added a third option: income averaging. This allows developers who choose the income averaging option to commit at least 40% of the units in a property to have an average designated income limit of no more than 60% AMI, with rents set at a fixed amount of 30% of a unit’s designated income limit. The developer decides the mix of designated income limits. The designated

income limits may be in 10% increments from 10%, 20%, 30%, 40%, 50%, 60%, 70%, up to 80% of AMI. A unit can only be occupied by a household with income equal to or less than the unit’s designated income with the rent for that unit fixed at 30% of the designated income limit (except any units designated 10% AMI units will be counted as 20% AMI units for income averaging). For example, if a unit is designated at 20% AMI, the household’s income must be equal to or less than 20% AMI and the maximum rent is capped at 30% of 20% AMI. If a unit is designated at 80% AMI, the household’s income must be equal to or less than 80% AMI and the maximum rent is capped at 30% of 80% AMI.

The purpose of the new income averaging option is to enable developers to offset lower rents for extremely low-income household by charging higher rents to households with income greater than the more traditional 60% AMI level. Advocates have some initial concerns about this new option, as discussed in the “Issues and Concerns” section of this article.

### LIHTC RENTS

Rent-restricted units have fixed maximum gross rents, including allowance for utilities, that are equal to or less than the rent charged to a hypothetical tenant paying 30% of either 50% of AMI or 60% of AMI, whichever option the developer has chosen. 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, LIHTC projects might simply not be financially available to extremely low-income households (those with income less than 30% of AMI) or very low-income households (those with income less than 50% of AMI) because rents charged are not affordable to them. HUD’s tenant-based or project-based vouchers or U.S.

Department of Agriculture Rural Development Section 521 Rental Assistance is often needed to fill the gap between 30% of a resident's actual income and the tax credit rent.

## LOWER-INCOME OCCUPANCY PERIOD

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 may 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. This Year 15 option is called the Qualified Contract (QC) and is discussed in the Issues and Concerns section of this article.

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. However, it is not clear the extent to which HFAs do monitor compliance after the 10-year credit period and following 5-year recapture period (see the Issues and Concerns section of this article).

## PROGRAM STRUCTURE

Although LIHTC is a federal program, each state has an HFA that decides how to award tax credits to projects. There are two levels of tax credit, 9% and 4% (discussed further below). The 9% tax credits are allocated to states by the U.S.

Treasury Department based on a state's per-capita population. In 2019, each state received \$2.76 per capita, with small states receiving a minimum of \$3.17 million. Each year the IRS adjusts the amount per state based on inflation and the latest population estimate. Because there is a fixed amount of 9% tax credits, they are very competitive. However, there is no direct limit on the amount of 4% tax credits an HFA can award. Instead, the 4% tax credit amount a state can award is indirectly limited by the amount of a state's Private Activity Bond volume cap, which seldom is a problem. The 4% tax credit can only be used in conjunction with a tax-exempt private activity bond.

Each HFA must have a qualified allocation plan (QAP) that sets out the state's priorities and eligibility criteria for awarding LIHTC, as well as tax-exempt bonds and any state-level tax credits. More about QAPs is presented later in this article. Developers apply to an HFA and compete for LIHTC allocations. The law requires that a minimum of 10% of an HFA's total LIHTC be set aside for nonprofits.

## LIMITED PARTNERSHIPS

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, along with other resources such as conventional mortgages, state loans, and funds from the HOME and HTF programs, is used by the developer to construct or substantially rehabilitate affordable housing.

The developer and investors form a “limited partnership” in which the developer is the “general partner” and the investors are “limited partners.” The general partner owns very little of the project (maybe as little as 1%), yet has a very active role in construction or rehab and day-to-day operation of the completed project. The limited partners own most of the project (maybe up to 99%) but play a passive role; they are involved only to take advantage of the reduction

in their annual federal tax obligations.

## 9% AND 4% TAX CREDITS

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%. That is, in the case of a 9% tax credit, 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 a minimum amount is spent on each rent-restricted lower-income unit or 10% is spent on the “eligible basis” (described below) during a 24-month period. Each year the IRS issues a revised minimum substantial rehab amount; for 2019 the amount is \$7,000.

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.
- Projects financed with tax-exempt private activity 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).

In recent years, the figures 9% and 4% were only approximate rates. IRS computed actual rates monthly based on Treasury Department interest rates, or “appropriate 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, or “placed in service.” This applicable percentage is applied to the “qualified basis” (described below) to determine the investors’ tax credit each year for 10 years (the “credit period”).

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% tax credit. There was no congressional action in FY13 or FY14 renewing a fixed 9% tax credit value. Although the “FY15 Appropriations Act” provided a fixed 9% minimum, it only extended the rate through December 31, 2014, providing virtually no benefit because most HFAs had already made their 2014 allocations and the vast majority of projects had closed using the floating rate. Therefore, the applicable percentage continued to float. For example, the 9% applicable percentage was 7.55% for December 2017.

Finally, on December 18, 2015, the president signed into law a broad tax extenders bill, the “Protecting Americans from Tax Hikes Act of 2015,” which, among many other tax provisions, made the fixed 9% applicable percentage permanent for new buildings placed in service after July 30, 2008. However, the statute did not establish a fixed 4% applicable percentage rate. The 4% tax credit continues to float, with an applicable percentage rate of 3.32% for December 2018.

## DETERMINING THE AMOUNT OF TAX CREDITS FOR A PROJECT

The amount of tax credit a project can receive, and therefore how much equity it can attract, depends on several factors. First, the “eligible basis” must be determined by considering costs 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 helping to finance a project.

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 (a Qualified Census Tract, or QCT) or a high-cost area (a Difficult to Develop Area, or DDA). QCTs are census tracts with a poverty rate of 25% or in which 50% of the households have income less than 60% of AMI. LIHTC projects in QCTs must contribute to a concerted community revitalization plan. The aggregate population in census tracts designated as QCTs cannot exceed 20% of the metropolitan area’s population. DDAs are areas in which construction, land, and utility costs are high relative to incomes. All DDAs in metropolitan areas taken together may not contain more than 20% of the aggregate population of all metropolitan areas. HERA expanded the use of the 30% basis boost to projects not located in QCTs or DDAs if an HFA determines that an increase in the credit amount is necessary for the project 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 (“placed in service”) is the minimum that must be maintained during the entire

affordability period (“compliance 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%). The amount of tax credits available to a project is divided among the limited partners based on each limited partner’s share of the equity investment. Investors receive their share of the tax credit each year over the 10-year “credit period.”

### A Simple Example

HUD’s HOME Program website once had a simple example that brings it all together:

Project will construct 70 units, 40% of them are income and rent restricted.

There are no other federal funds.

The example in Table 1 continues, noting that a limited partnership will buy the tax credits at \$0.75 for every dollar of future tax benefit (the tax credit “price”). Thus, the limited partnership will invest \$1,080,000 ( $\$1,440,000 \times .75$ ) in the project today for a 10-year stream of future tax benefits amounting to \$1,440,000.

## QUALIFIED ALLOCATION PLAN

The statute authorizing the LIHTC program requires each agency that allocates federal LIHTCs, (usually HFAs), to have a Qualified Allocation Plan (QAP). Each state has an HFA and there are also a few local HFAs. The QAP sets

**TABLE 1**

|  |                     |             |
|--|---------------------|-------------|
| Total development costs  | \$5,000,000         |             |
|  | Land acquisition    | \$1,000,000 |
|  | Construction        | \$3,400,000 |
|  | Site Improvements   | \$ 535,000  |
|  | Engineering         | \$ 40,000   |
|  | Eligible Soft Costs | \$ 25,000   |
| Eligible Basis: Total Development Cost – Land Acquisition = \$4,000,000                          |                     |             |
| Qualified Basis: Eligible Basis x Applicable Fraction ( $\$4,000,000 \times .40$ ) = \$1,600,000 |                     |             |
| Annual Tax Credit: Qualified Basis x Tax Credit Rate ( $\$1,600,000 \times .09$ ) = \$144,000    |                     |             |
| Total Amount of Tax Credits: $\$144,000 \times 10$ years = \$1,440,000                           |                     |             |

out a state’s eligibility criteria and priorities for awarding federal LIHTCs to housing properties. In some states, the QAP also sets out threshold criteria for non-competitive 4% tax credits and any state LIHTC.

The QAP is a tool advocates can use to influence how their state’s share of annual federal LIHTCs is allocated to affordable housing properties. Advocates can use the public hearing and comment requirements to convince their housing finance agency to better target tax credits to properties with extremely low-income households, locate projects in priority areas (particularly to affirmatively further fair housing), and preserve the existing stock of affordable housing.

Each QAP must specify an HFA’s minimal criteria and priorities that it will use to select projects competing for tax credits. The priorities must be appropriate to local conditions. The statute requires a QAP to give preference to projects:

- Serving residents with the lowest income.
- Serving income-eligible residents for the longest period of time.
- Located in HUD-designated QCTs, as long as the project contributes to a “concerted community revitalization plan” (QCTs are census tracts with a poverty rate of 25% or in which 50% of the households have income less than 60% of AMI).

In December 2016, the IRS issued Notice 2016-77 stating that QAPs may only give preference to projects in QCTs if there is a “concerted community revitalization plan” and only if that plan contains more components than just the LIHTC project. That Notice observed that in some cases HFAs have given preference to projects located QCTs without regard to whether the projects would contribute to a concerted community revitalization plan. In other cases, because development of new multifamily housing benefits a neighborhood, a LIHTC project without other types of community improvements has been treated as if it alone constituted a concerted community revitalization plan. The IRS declared that simply placing a LIHTC project in a QCT risks exacerbating concentrations of

poverty. Therefore, a QCT preference should only occur when there is an added benefit to the neighborhood in the form of the project’s contribution to a concerted community revitalization plan. The Notice requested public input to define “concerted community revitalization plan” because the IRS Code does not have a definition. To date, the IRS has not proposed definitions of “concerted community revitalization plan.”

The QAP selection criteria must address 10 items: (1) location, (2) housing needs, (3) public housing waiting lists, (4) individuals with children, (5) special needs populations, (6) whether a project includes the use of existing housing as part of a community revitalization plan, (7) project sponsor characteristics, (8) projects intended for eventual tenant ownership, (9) energy efficiency, and (10) historic nature. These requirements are minimums; states may adopt more rigorous criteria that target advocates’ priority populations and locations. Most states establish detailed QAP selection criteria and set-asides based on the characteristics of their state’s needs.

HFAs may target tax credits in several ways:

- The QAP selection process may give preferences, in the form of extra points, to encourage developers to submit projects more likely to serve particular populations or locations; for example, by awarding 10 points to projects that set aside 10% of the units for special needs populations.
- The QAP may establish a set-aside, reserving a specific percentage or dollar amount of any given year’s tax credit allocation for projects more likely to serve particular populations or locations; for example, a \$20 million set-aside for rural projects.
- The QAP may establish thresholds, minimum requirements that projects must meet simply to get in the game, thus improving targeting to particular populations or locations; for example, requiring a 50-year income-eligible compliance period.

## TIPS FOR LOCAL SUCCESS

Because each state receives a new allocation of LIHTCs each year, QAPs are usually drafted annually. This gives advocates regularly scheduled opportunities to influence QAP priorities. LIHTCs are often in high demand among developers; therefore, developers propose projects that address the priorities set forth in the QAP to give themselves an advantage in the selection process.

Advocates should assess the QAP. If it only has a general statement of goals, advocates can work to get very specific set-asides or preference points for their priorities. If the QAP has too many priorities, this will render individual priorities less meaningful. Advocates should work to narrow the number of priorities or work to establish relative priorities so their priorities can compete more effectively.

If there are types of assisted housing that should be at the top of the priority list, advocates should work to ensure that they are positioned to better compete. For example, if there is a great need for units with more than two bedrooms, advocates might promote a QAP policy offering bonus points for projects providing units with two or more bedrooms for at least 10% of all low-income units. To facilitate rural projects, advocates might try to secure QAP policies that give points to projects with fewer than 50 units in rural areas.

Advocates can also argue for features that protect tenants, for example a QAP policy precluding tax credit assistance for projects that do not provide one-for-one replacement of units lost through redevelopment. Advocates should review the QAP to find out how long targeted units must serve lower-income people. If the QAP only requires the basic 15 years, plus the extended use period of another 15 years, advocates should try to get the compliance period lengthened as a threshold issue, or try to get point preferences or set-asides for projects that voluntarily agree to a longer compliance period.

All states are required to have a public hearing about their proposed QAP before it is approved

by the unit of government overseeing the HFA, but there are no specific requirements for the public hearing. Although not required, most states also provide for a public review and comment period for a proposed QAP.

Advocates should contact the HFA early to learn about its annual QAP process and build this into their work plan for the year. In addition, advocates should be sure to get on any notification list the HFA might have about the QAP and public hearing. Advocates should also develop relationships with the HFA's governing board and communicate the advocate's priorities throughout the year. Not all communication has to take place in the context of the formal QAP process. Informal contacts can be used effectively to advance an advocate's priorities. In fact, the most effective means of advocating for any particular priority is to be in contact with the HFA long before a draft QAP is publicly released.

Once an HFA decides to award tax credits to a building, it must notify the chief executive officer of the local jurisdiction, such as the mayor or county executive, where the building is located. That official must have a reasonable opportunity to comment on the project. Advocates should ask the executive's office and any relevant housing department at the locality to notify them as soon as the HFA contacts the executive about a proposed project. Even better, advocates should seek a local policy requiring public notice and comment, along with public hearings, about a proposed project.

In December 2016, the IRS issued Revenue Ruling 2016-29 holding that the IRS Code does not require or encourage state agencies allocating LIHTCs to reject proposals that do not obtain the approval of the locality where a project is proposed to be developed. IRS added that QAP policies that require local officials to approve a proposed project could have a discriminatory effect based on race and therefore be contrary to the "Fair Housing Act of 1968."

Before tax credits are allocated, there must be a comprehensive market study of the housing needs of low-income people in the area a project

is to serve. The project developer must hire a disinterested third party approved by the HFA to conduct the market study.

If a building that does not fit the QAP's priorities is to get tax credits, the HFA must provide a written explanation and make it available to the public.

Most states post a list of properties that have won tax credits after each round of competition. These lists can often be found on an HFA's website.

## ISSUES AND CONCERNS

Advocates have growing concerns about four practices that can affect LIHTC properties keeping income and rent restrictions: Properties reaching Year 30 and the potential loss of rent-restricted units, Qualified Contracts (QCs), “planned foreclosures,” and the extend that HFAs monitor projects for compliance with income and rent restrictions for the full 30-year (or longer) extended use period. In addition, there are potential issues with the new “income averaging” option.

### Income Averaging

The “FY18 Appropriations Act” introduced a third option for meeting an LIHTC lower-income unit set-aside: income averaging. This allows a developer to commit at least 40% of the units in a property to have an average designated income limit of no more than 60% AMI, with rents set at a fixed amount of 30% of a unit's designated income limit. The IRS has not issued guidance for using the income averaging option, and it is not expected to.

The primary concern is that there is potential for fewer LIHTC units being available to extremely low-income households with Housing Choice Vouchers. As previously noted, researchers have found that 45% of all LIHTC households have extremely low income and that 70% of these ELI households have rental assistance in order to be able to afford their LIHTC unit. The researchers could not discern whether the rental assistance was from Housing Choice Voucher or project-based Section 8. A public housing agency's

(PHA's) voucher “payment standard” might not be enough to meet the contract rent, the actual rent charged by the owner of the LIHTC unit (the payment standard is the amount of the voucher that makes up the difference between the contract rent charged by the owner and the tenant's share of the rent at 30% of the tenant's adjusted income). The payment standard is very likely to be inadequate for units designated at 70% AMI or 80% AMI in areas that have high overall AMIs.

The National Housing Law Project (NHLP) provides an example of a 50-unit building with five units at 80% AMI, 15 units at 70% AMI, five units at 60% AMI, 15 units at 50% AMI, and 10 units at 40% AMI. The average AMI in this example is 58%, but 20 out of the 50 units may be out of reach for voucher households. NHLP suggests that advocates convince their state's QAP to have incentives or requirements that the highest LIHTC rents be set at or below the local voucher payment standard.

Another potential problem is that income averaging might lead to fewer larger units for ELI households even though the community might need more larger units for ELI households. The income averaging calculation does not take into consideration unit size. A property could designate most of the smaller units at the lowest AMI and most of the larger units at the highest AMI and still come in at an average AMI less than 60% of AMI.

## BEYOND YEAR 30

A NLIHC report, *Balancing Priorities: Preservation and Neighborhood Opportunity in the Low-Income Housing Tax Credit Program Beyond Year 30*, finds that 8,420 LIHTC properties accounting for 486,799 LIHTC units will reach Year 30 between 2020 and 2029. This is nearly 25% of all current LIHTC units. For-profit owners have 336,089 (69%) of these units, placing the units at risk after Year 30. At least 81,513 (17%) of these units have nonprofit owners so will likely continue to operate as “affordable” housing – if there is adequate support to make needed repairs for aging units.

Between 2020 and 2029, 42% of the LIHTC units losing their affordability restrictions are in neighborhoods with very-low desirability and 26% are in low-desirability neighborhoods. It is these units that likely face the most significant challenges meeting capital needs for rehabilitation because they can only rely on lower rental income.

On the other hand, 10% of the LIHTC units with expiring affordability restrictions are in high-desirability neighborhoods and another 5% are in very-high desirability neighborhoods. For-profit developers own 36,282 units in high-desirability neighborhoods and another 16,641 units in very-high desirability neighborhoods. These units owned by for-profit entities are likely at the greatest risk for being repositioned as market-rate housing.

## QUALIFIED CONTRACTS

As explained earlier, an owner may 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. This is called a Qualified Contract (QC). The HFA then has one year to find a buyer willing to maintain the income and 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 income- and rent-restricted units is removed and the lower income tenants receive enhanced vouchers enabling them to remain in their units for three years. The IRS code specifies the price that a preservation purchaser must pay in a QC situation, and in most cases the price is far greater than market price. Consequently, preservation purchasers are unable to acquire a LIHTC property at year 15 and the property converts to market-rate, and income and rent restrictions are removed.

To prevent the loss of affordable housing, some HFA’s QAPs require LIHTC applicants to waive their right to a QC or give extra competitive points to proposals agreeing to waive the right to a QC. Some HFAs inform LIHTC applicants that if they eventually seek a QC, they will not be allowed to apply for LIHTCs in the future.

The National Council of State Housing Agencies updated its “Recommended Practices in Housing Credit Administration” in December, 2017. It recommended that all states should require LIHTC applicants to waive their right to a QC for both 9% and 4% LIHTCs. In addition, it recommended that QAPs include disincentives for owners of existing LIHTC properties to seek a QC by awarding negative points should an owner apply for future LIHTCs.

### Planned Foreclosures

Another concern is with entities that appear to engage in strategic acquisition of LIHTC-funded properties after the LIHTC is allocated (and, in many instances, already claimed) with the hope of avoiding the LIHTC use restrictions. Advocates have identified “planned foreclosures,” actions by partners in LIHTC developments designed to result in a foreclosure and thus wipe out the affordable use restrictions. In such cases, the entity planning the foreclosure was not involved in the LIHTC application process and is not an entity that applies for LIHTCs. Instead, the entity buys into the development, loans itself money through distinct but related companies, and then essentially forecloses on itself after claiming that properties are unsuccessful. Unlike HFA-trusted partners that are sensitive to their standing with the HFA because they hope to secure LIHTCs in the future, planned foreclosure entities do not seek future LIHTC allocations. Because such firms operate outside of the QAP process, eligibility for future LIHTCs does not work as a disincentive to avoiding use restrictions.

Congress specifically gave the Treasury Secretary the authority to determine that such intentional transactions do not qualify as foreclosures that terminate the LIHTC affordable use requirements. Although the LIHTC program has been in existence for more than 30 years, the IRS has provided no guidance to HFAs regarding how to deal with these situations.

## COMPLYING WITH USE RESTRICTIONS AFTER YEAR 15

Although HFAs are tasked with monitoring compliance, additional guidance is needed

to ensure that properties are complying with regulations through the extended use period, the period after year 15 to at least year 30 (and for some states longer). During the initial 10-year credit period and the five-year recapture period, developments are less likely to have compliance issues because they are subject to losing tax credits. However, during the following extended use period, it is difficult to encourage compliance because there are few penalties for failing to do so. HFAs focus compliance monitoring and enforcement during the initial 15-year term. This is problematic given that a property is more likely to have compliance issues as it ages. IRS needs to develop guidance or new regulations to require HFAs plan for how they will ensure compliance throughout the entire restricted use period.

## FUNDING

The LIHTC is a tax expenditure, which does not require an appropriation. The Joint Committee on Taxation estimated that the program would cost \$9.4 billion in tax expenditures in 2019, rising to \$11 billion in FY20, \$10.4 billion in FY21, \$10.7 billion in FY22, with a total of \$49.5 billion between FY18 and FY22.

## FORECAST FOR 2019

Although the LIHTC was preserved in the “Tax Cuts and Jobs Act of 2017,” its ability to generate equity may be reduced because the act significantly lowered the corporate tax rate from 35% to 21%. In spring 2018, Congress provided a temporary 4-year, 12.5% increase to the LIHTC to help address this negative impact.

Given the need for affordable rental homes for people with the lowest incomes, Congress should pair any expansion of the LIHTC with reforms to ensure that this resource can better serve the most vulnerable families. For that reason, NLIHC urges Congress to enact the “Affordable Housing Credit Improvement Act,” introduced by Senators Maria Cantwell (D-WA) and Orrin Hatch (R-UT) in 2017 (a new Republican cosponsor is expected to lead on the bill, given Senator Hatch’s retirement in 2018). The bill would expand LIHTC by 50% over five years, as well as

improve the program by making reforms such as:

- Providing a 50% basis boost, thereby increasing investment in a project, for developments that set aside at least 20% of the units for extremely low-income households (those with income less than 30% of AMI or income less than the federal poverty level). With this much-needed financial incentive, the bill would help housing developments remain financially sustainable while serving families with limited means.
- Encouraging development in Native American communities by designating Native American communities as Difficult to Develop Areas (DDAs), thus making developments automatically eligible for a 30% basis boost. The bill also requires states to consider the needs of Native Americans when allocating housing tax credits.
- Requiring the Treasury Department to issue guidance prohibiting states from including local approval and contribution provisions as either threshold requirements or elements of a point system.
- Requiring HFAs to establish definitions and clear parameters for concerted community revitalization plans before projects proposed for QCT can obtain a 30% basis boost.
- There may be opportunities to move some, or all, of the provision in the Cantwell/Hatch bill in 2019, as Congress looks to enact a tax extenders package.

## FOR MORE INFORMATION

NLIHC, 202-662-1530,  
<https://nlihc.org/explore-issues/housing-programs/tax-reform>.

A NLIHC’s report, *Balancing Priorities: Preservation and Neighborhood Opportunity in the Low-Income Housing Tax Credit Program Beyond Year 30*,  
<https://nlihc.org/resource/balancing-priorities-report>.

National Housing Law Project,  
<https://www.nhlp.org/resource-center/low-income-housing-tax-credits>.

Affordable Rental Housing A.C.T.I.O.N. Campaign, <http://rentalhousingaction.org>.

HUD's database of LIHTC projects, updated through 2016, [www.huduser.org/datasets/lihtc.html](http://www.huduser.org/datasets/lihtc.html).

HUD's list of QCTs and DDAs, [www.huduser.org/datasets/qct.html](http://www.huduser.org/datasets/qct.html).

HUD's lists of HFAs, [https://lihtc.huduser.gov/agency\\_list.htm](https://lihtc.huduser.gov/agency_list.htm).

Novogradac, a consulting firm, also lists the HFAs in all states and provides links to their QAPs, <http://bit.ly/XoOL2b>.

The National Council of State Housing Agencies (NCSHA) has:

- Recommended practices for administering the LIHTC program, <https://www.ncsha.org/resource-center/housing-credit-recommended-practices>.
- A list of state HFAs, <https://www.ncsha.org/membership/hfa-members>.
- A list of state income averaging policies, <https://www.ncsha.org/resource/state-income-averaging-policies>.