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Tax Reform's Thumbs Up for the Low-Income Housing Credit

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The low-income housing credit ("LIHTC") is a federal tax credit for investors in low-income housing projects. Although recent tax reform proposals indicate the LIHTC will not be eliminated, this article points out that the affordable housing industry could nevertheless be affected by a change in the federal tax law.

In June of last year, the House Ways and Means Committee's tax reform Blueprint[1] proposed to eliminate various "special interest deductions and credits" designed to encourage particular business activities (except for the research and development credit ("R&D credit")). This language along with President Trump's campaign proposal to eliminate most "tax expenditures" (but not the R&D credit) has had a chilling effect on tax equity investments in LIHTC projects. Deals slowed and pricing dropped as investors considered the potential repeal of the LIHTC and the effect of lower corporate tax rates.

The recent GOP "Unified Framework" for tax reform envisions the repeal of certain business credits, taking into account budgetary limitations, but "*explicitly preserves*" the low-income housing credit along with the R&D credit.[2] This is good news for the affordable housing industry because investors can have

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1 House of Representatives Republican Tax Reform Task Force, A Better Way—Our Vision for a Confident America (June 24, 2016).

2 Unified Framework for Fixing Our Broken Tax Code (Sept. 27, 2017) (developed by the White House, Republican leaders of the U.S. House and Senate, and the chairs of the House and Senate tax-writing committees).

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greater confidence in making investments in LIHTC transactions. This is also good news for those in need of affordable housing as an average of over 1,460 projects and 110,000 units that took advantage of the LIHTC program have been placed in service annually between 1995 to 2015, making the LIHTC program a very important source of funding for affordable housing in the United States today.[3]

Nevertheless, lower corporate tax rates remain a concern for housing developers. Companies that have invested in LIHTC in the past may not have sufficient tax liability to continue to invest. In addition, in a lower corporate rate environment, the value of depreciation deductions allocated to the investor would be reduced. For new transactions, developers and investors are putting in place special pricing provisions to take into account the impact of potential tax law changes, but the reality is that less tax equity may be available to support future LIHTC projects.

Keep in mind that enactment of tax reform is not certain. Further, even if tax reform legislation is enacted, the timing, substance, technical details, and effective dates of provisions are not certain.

How the LIHTC Currently Works

Investors receive a federal tax credit for investments in low-income housing projects. The amount of the annual credit equals a percentage of a building's eligible basis relating to the low-income units times the tax credit rate for each year of the 10-year credit period.

For new construction and qualified rehabilitation costs, the tax rate is fixed at nine percent. For existing buildings and tax-exempt bond financed buildings, the tax rate fluctuates and is currently 3.21 percent calculated on approximately 30 percent of the building's qualified basis.

Generally, eligible basis is equal to the building's adjusted depreciable basis, certain tangible property such as refrigerators and stoves, and certain common area costs. However, special rules allow a building's eligible basis to be increased by up to 130 percent (basis boost) if it is located in a qualified census tract or in an area that is difficult to develop. In addition, state allocating agencies may designate a *non-tax-exempt bond financed* building as being located in a difficult to develop area in order for the project to be financially feasible as a low-income housing project.

For a project to qualify as a LIHTC project, a certain percentage of the units must be low-income units. Under this rule, the owner of the project may elect that 20 percent of the units are occupied by tenants earning 50 percent or less of the area median income, or 40 percent of the units are occupied by tenants earning 60 percent or less of the area median income. In addition, the rents on low-income units must be no more than 30 percent of the income limitation as elected by the owner. The minimum set aside of low-income units and rent restriction requirements must remain in place throughout the 15-year LIHTC compliance period plus an additional minimum 15-year extended low-income housing commitment period as agreed to between the owner and the allocating agency.

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[3] Office of Policy Development and Research, U.S. Department of Housing and Urban Development, Datasets: Low-Income Housing Tax Credits (July 10, 2017), https://www.huduser.gov/portal/datasets/lihtc.html.

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Recapture can occur at any time during the 15-year compliance period. Generally a recapture event occurs if the percentage of low-income units decreases from the previous year. While a qualified low-income building must remain in compliance for 15 years, the LIHTC is claimed over an accelerated 10-year credit period. The credit recapture amount equals as much as one-third of the accelerated portion of the credit claimed in all previous years with respect to the decrease in qualified basis plus interest at the overpayment rate.

There is no recapture for a disposition of the building or an interest in a LIHTC building held through a partnership if a reasonable expectation exists that the purchaser will continue to maintain the building as a qualified low-income housing project.

State Housing Agency Oversight and Compliance Monitoring

Each state housing agency receives a tax credit allocation amount based on its population times a dollar amount (adjusted for inflation). For 2017 allocations, the credit allocation is equal to the greater of: (i) $2.35 times the state population, or (ii) $2,710,000.

A unique feature to LIHTC projects is that each state participates in the selection of qualified projects under its qualified allocation plan,[4] which sets out specific criteria projects must meet in order to receive an allocation of credit. This process ensures that the selected projects address the specific needs of each state and otherwise meet the LIHTC requirements and congressional policy.

Further, the state housing agencies monitor compliance for each project throughout the 15-year compliance period and enter into regulatory agreements with the owner of the project to maintain the low-income housing requirements including any special state housing needs for an extended period beyond the LIHTC compliance period.

Despite recent criticisms of some state housing agencies' practices,[5] the overall result has been a remarkably effective affordable housing program that targets housing needs to the needs of each state. In addition, most large banking investors and syndicators provide their own asset management oversight,[6] ensuring that the projects remain compliant throughout the compliance period. Hopefully, tax reform will continue to preserve and improve the LIHTC program.

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4 Section 42(m).

5 S. Reaman, *Government Accounting Office Recommends Ways to Strengthen the Low-Income Housing Credit Program*, What's News in Tax (Sept. 18, 2017).

6 *See* GAO, Low-Income Housing Tax Credit: The Role of Syndicators (Feb. 16, 2017); OCC, Low-Income Housing Tax Credits: Affordable Housing Investment Opportunities for Banks (Mar. 2014, rev. Apr. 2014).

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