

# The Tax Credit Turns 20 and Changes Are Coming

2007 marks the 20th anniversary of the Low Income Housing Tax Credit program. Coincidentally, the new leadership in Congress is considering significant changes to the Tax Credit program for the first time in many years. Participants will learn about legislation pending in Congress to improve the Low Income Housing Tax Credit program, hear from an expert panel about their views and then have an opportunity to share their own ideas.

**Convener/Moderator:** Matt Schwartz, California Housing Partnership Corporation

## **Speakers:**

1. Bill Pavao, California Tax Credit Allocation Committee
2. Sue Reynolds, Community Housing Works
3. Evan Becker, RED Capital

## **Agenda:**

1. Purpose/Context
2. Introductions
3. Proposed Consent Agenda
4. Presentation and panel discussion of Tax Credit reform measures
5. Additional ideas and discussion from the audience

LIHTC REFORM PROPOSAL	PURPOSE/DETAILED PROPOSAL	Impact on Fed. Budget?	Import. to CA Users to Advocate
<b>I. CRITICAL AND CONTROVERSIAL PROPOSALS</b>			
Allow max. income to 80% AMI where there are severe shortages of housing for this income group	<p>States would be allowed to authorize developers to rent to incomes up to 80% of AMI in communities designated based on a shortage of rental housing for households with incomes 60-80% AMI. Relationship between FMRs and AMIs would be major factor.</p> <p>To insure that there would still be affordable housing developed for lower income tenants, states <u>could be</u> required to assure an equal number of units be available to tenants with incomes lower than 60% of AMI (income skewing).</p>	None	High
Change annual rent increase formula	<p><u>Status Quo</u>: Rent increases capped based on annual change in AMI except held harmless when AMI declines.</p> <p><u>NAHB Proposal</u>: Index LIHTC rents to CPI after initial rents set.</p> <p><u>NAHB: Rationale</u>: Would protect owners from flat or declining AMIs and create more certainty for owners and tenants.</p> <p><u>HUD Proposal</u>: When AMIs have declined, rents set at greater of 100% of prior year rent or 100% of prior year + 50% of increase in AMI from prior year (avoids problem of flat rents for extended period). For example, if this year's AMI is 104 percent of last year's, the income increase would be 102 percent. If this year's AMI is 97 percent of last year's, the income increase would be 100 percent.</p> <p><u>Alternative Proposal</u>: Regardless of change in AMI, rents always set at greater of 100% of prior year or 100% of prior year plus 50% of increase in AMI from prior year. Rationale: in return for lessening risk of flat rents, owners give up possibility of larger increases.</p>	None	High

<p>Allow a 30% increase in eligible basis for properties that meet state-specified geographic or income targeting requirements.</p> <p>Question: Regional vs. incentive for deeper income targeting?</p>	<p>Developments located in HUD-determined “high-cost areas”—defined as qualified census tracts (QCT) and difficult development areas (DDA)—are eligible to receive additional Credit. States are able to grant this increased Credit amount to properties in these areas that demonstrate the additional subsidy is necessary to make them feasible.</p> <p>There are many areas not designated as QCTs or DDAs that also need this 30% “basis boost” to make development possible. Many economically distressed and rural areas fall into this category. Similarly, there are types of developments, such as those targeted to serve very and extremely low-income families, that could be made feasible with the additional credit.</p> <p>States are best suited to judge the development types or those areas in which properties most need additional subsidy. The proposal would give states the authority to increase Credit awards by 30% where properties meet state-specified geographic or income targeting requirements.</p>	None	High
<p>Land included in basis and/or 9% credit for acquiring building</p>	<p>Allows for projects in high cost communities where land constitutes a greater part of the cost of development. State HFA would assure that the subsidies will not be excessive.</p>	Some in bond projects	High
<p>Allow projects w/ HOME \$ to be eligible for DDA/QCT increases</p>	<p>The proposal would allow HOME-assisted Credit developments to receive the 30% basis boost permitted all other Credit properties. This change is intended to facilitate development of deeper income targeting in high-cost areas. HFA will control excess subsidy via SLR.</p>	None	High

<p>Clarify utility allowance to:</p> <p>1. IRS publishes regs process for setting project-specific allowances.</p> <p>2. Remove UA altogether and adjust rent schedule?</p>	<p>IRS needs to publish regulations which would provide for a more accurate calculation of utility allowances – particularly for newer, energy efficient properties. When the UA increases, the rent to the owner decreases and if UA increases exceed AMI increases, the property could become infeasible and unsustainable.</p> <p>Consider allowing state HFAs to convert the utility allowance into a percentage of maximum gross rent at the time of underwriting. Regardless of the level of future rents, an owner could estimate more accurately their cash flow over the life of the project, which improves their ability to cover unanticipated spikes in operating costs and attract private equity into the project. In theory, utility expenses could increase by more or less than the percentage assumed at underwriting; however, that percentage should capture plausible ranges for these future expenses.</p>	None	Medium
<p>Repeal the 10% expenditure carryover rule</p>	<p>Replace the requirement that 10% of the expected project costs be incurred within six months after receiving a Housing Credit allocation (or by the end of the calendar year if later) with direction that states should ensure that projects are ready to proceed. The current provision requires the expenditure of substantial legal and accounting costs, and does not achieve the desired policy result.</p>	None	High
<p>Lower the threshold for % ownership change when issuing new credits from 90% to 50%</p>	<p>Require at least 50% change in ownership when allowing acquisition Credits for properties that previously used Housing Credits (typically at least 15 years earlier). Current law requires a 90% ownership change; the 50% standard is the tax code norm (per §§267(b) and 707(b)). The current standard is unworkable because a limited number of corporations supplies most of Housing Credit investment, and unnecessary because states allocate Housing Credits only to priority projects through a highly competitive process.</p>	None	High

<b>II. IMPORTANT NONCONTROVERSIAL PROPOSALS</b>			
Make credit higher of 70%/30% present value or 9%/4%	<p>Provide certainty for investors. Each month, Treasury must calculate the annual Housing Credit percentage based on federal mid- and long-term interest rates. This is designed so that the so-called 4% and 9% Credits will yield a present value of 30% and 70%, respectively, over the 10 year Credit period.</p> <p>This “floating rate” system creates uncertainty for owners and investors. It also complicates state administration by limiting agencies’ ability to conduct subsidy analysis. Fixing the annual Credit percentages would eliminate the uncertainty and financial risk of the current floating rate system, simplify state administration, and facilitate applicant document preparation.</p>	Only with respect to bond projects	High
Subsidy Layering to be done by state agency	Simplifies process and speeds up approval process. (Probably within joint jurisdiction of W&M and Financial Services)	None	High  In H.R. 1851
Eliminate Recapture Bond upon sale	The current recapture bond is unnecessary, inefficient, and burdensome. Eliminating the requirement would add liquidity to the investment market and expand the volume of available investment.	None	High
Do not reduce basis for §236 IRP and similar operating subsidies	IRP should be considered a rent subsidy that does not reduce basis. This will allow for more conversions of §236 projects and extend affordability.	Some	High

<p>Eliminate the Limitation to 30% PV credit when federal subsidies are involved- except for tax exempt debt</p>	<p>Makes deeper targeting easier to achieve. <i>(Should deeper targeting be required)</i> Federally subsidized buildings receive only the 4% Credit for new construction or substantial rehab. Federally subsidized buildings as those financed with tax-exempt bonds or below-market federal loans.</p> <p>Congress established the 4% Credit before states were required to underwrite developments. Now that states must limit Credit allocations to the amount necessary to achieve financial feasibility, the 4% limit is not necessary and sometimes precludes development of properties with deep-income targeting.</p> <p>The proposal would provide states the flexibility to allocate higher Credit amounts to enable the development of properties that are otherwise financially infeasible. The proposal would aid affordable housing production, especially in light of the scarcity of state and local subsidies. The change would also support the development of properties that cannot support much debt, such as special needs properties.</p> <p>States would still be subject to the current annual Housing Credit cap. The statutory requirement that states allocate properties only the amount of Credit necessary for their financial feasibility and long-term viability as low-income housing prevents over subsidization.</p>	<p>None</p>	<p>High</p>
<p>Eliminate 10-year rule</p>	<p>Anti-churning rule no longer necessary because of time passed since tax shelters.</p>	<p>None</p>	<p>High  (contro- versial?)</p>

<b>III. LESS IMPORTANT/NON CONTROVERSIAL PROPOSALS (Consent Agenda)</b>			
Allow payment of §8 rents in excess of the LIHTC rents	Allows for properties sufficient funding. This change is critical to expanding the supply of affordable housing particularly in high housing cost areas. This provision was included in H.R. 5443, the “§8 Voucher Reform Act of 2006,” which was approved by the House Financial Services Committee last year. (Probably within the jurisdiction of Financial Services.)	None	High  DONE by HUD
Allow use of credits with Mod Rehab	Prohibition no longer needed because of SHFA review	None	Medium
Eliminate reduction in basis for Historic and other credits	Make easier to rehab historic housing properties. SHFA would assure that there would not be an excessive subsidy.  Energy credits too?	Some in bond projects	Medium
Simplify the rules for community facilities	To facilitate the inclusion of community service facilities in smaller projects in low-income communities, expand eligible basis for these facilities to 20% of first \$5 million (indexed for CPI) and 10% thereafter. Current law permits a flat 10%	None	Low-Medium
Amend rules for projects affected by a casualty	Allow Housing Credits to continue on a property suffering a casualty loss during rehabilitation or reconstruction, provided that the compliance period is extended by the term of the property’s rehabilitation or reconstruction. New construction vs. existing buildings or both?		Low-Medium

<p>Exempt LIHTC from Corporate AMT</p>	<p>Increase market for credits- increase equity into projects.</p> <p>Housing Credit investors may use Housing Credits to reduce regular income tax liability but not the AMT. More and more corporate taxpayers are, or will be in the future, subject to the AMT. To the extent potential Credit investors fear becoming subject to the AMT, they will either pay less for the Credit, reducing the dollars available from the Credit for housing, or refuse to buy Credit at all.</p> <p>The proposal would allow corporate taxpayers to use the Credit to reduce their AMT liability in order to increase Credit demand, thereby increasing the amounts investors are willing to pay for the Credit and the equity the Credit generates.</p> <p>Currently, the foreign tax credit, the alcohol fuels credit, and the credit for electricity or refined coal are fully applicable against AMT liability.</p>	<p>Small</p>	<p>Low</p>
<p>Reconcile rules on next available unit, student definitions, SRO, and review process for credit and bond projects.</p>	<p>Rules should be the same. Under both the multifamily Housing Bond and Housing Credit programs, a low-income unit is defined as over-income if the tenant's income exceeds the applicable eligible income limit by more than 40%. Under both programs, the owner may continue to treat the over-income unit as a low-income unit and avoid recapture if the owner leases the next available unit of comparable or smaller size to a qualified low-income tenant.</p> <p>In the Credit program, the rule applies to each building within a development. In the multifamily Housing Bond program, the rule applies on a development-wide basis, even if the development consists of multiple buildings. Both rules apply to developments financed with both Credits and multifamily bonds. The proposal would simplify management and compliance monitoring of developments financed with both Credits and Bonds.</p>	<p>Some, if it encourages more bond financed projects</p>	<p>Low</p>