REFORM AND EXPAND THE LOW-INCOME HOUSING TAX CREDIT (LIHTC)

Current Law

If a taxpayer owns rent-restricted rental housing that is occupied by tenants having incomes below specified levels, the taxpayer may claim LIHTCs over a 10-year period. The credits earned each year generally depend on three factors—the portion of the building devoted to low-income units, the investment in the building, and a credit rate (called the "applicable percentage").

Computation of the credit amount

For a building to qualify for LIHTCs, a minimum portion of the units in the building must be rent-restricted and occupied by low-income tenants. Under section 42(g)(1) of the Code, the taxpayer makes an irrevocable election between two criteria. Either: (1) At least 20 percent of the units must be rent-restricted and occupied by tenants with income at or below 50 percent of area median income (AMI); or (2) At least 40 percent of the units must be rent-restricted and occupied by tenants with incomes at or below 60 percent of AMI. In all cases, qualifying income standards are adjusted for family size. Maximum allowable rents are restricted to 30 percent of the elected income standard, adjusted for the number of bedrooms in the unit.

The amount of the investment used in the credit calculation (the "qualified basis") is the product of the portion of the building attributable to low-income units times the building's "eligible basis" (generally, depreciable basis at the end of the first taxable year in the credit period). In some cases, however, to enhance the economic feasibility of a project, the Code increases eligible basis by 30 percent (thus increasing the owner's LIHTCs by 30 percent) (a "basis boost").

For example, a basis boost applies to buildings in Qualified Census Tracts (QCTs). A QCT is a census tract that is characterized by a specified poverty rate or by a specified concentration of low-income residents and that is designated as a QCT by the Department of Housing and Urban Development (HUD). These designations, however, may not be made for a combination of census tracts in a metropolitan statistical area (MSA) if the aggregate population of the combination of tracts exceeds 20 percent of population of the MSA.

There are two applicable percentages, referred to as the 70-percent present value credit rate and the 30-percent present value credit rate. Each month, the IRS announces these rates. The stated goal is rates such that the 10 annual installments of the credit have a present value of 70 percent (or 30 percent) of the total qualified basis of the property. The Code prescribes a risk-free discount factor and other computational assumptions that the IRS must use in setting the rates.

There is a minimum applicable percentage of nine percent for the 70-percent present value credit rate for buildings placed in service after July 30, 2008.

Additional prerequisites for earning LIHTCs

Credits are not available unless occupancy is available to the general public. Section 42(g)(9), however, clarifies that a project does not fail to meet this general public use requirement solely because of occupancy restrictions or preferences that favor tenants with special needs, tenants who are members of a specified group under certain Federal or State programs, or tenants who are involved in artistic or literary activities.

To ensure that low-income buildings remain low-income buildings for decades, no LIHTCs are allowed with respect to any building for any taxable year unless an extended low-income housing commitment (Long-Term-Use Agreement, or Agreement) is in effect as of the end of the year. A Long-Term-Use Agreement is a contract between the owner of the property and the applicable State housing credit agency (Agency). The Agreement must run with the land to bind future owners of the property for three decades or more, and certain provisions of the Agreement must be enforceable in State court not only by the Agency but also by any past, present, or future income-qualified tenant. In addition to requiring that certain minimum portions of a building be low-income units, the Long-Term-Use Agreement must mandate certain conduct in the management of the building, including prohibiting the refusal to lease because the prospective tenant is a holder of a voucher or certificate of eligibility under section 8 of the United States Housing Act of 1937 and prohibiting eviction (other than for good cause) of any existing tenant in a low-income unit.

The allocation process

Every year, the Code provides each State with a limited number of LIHTCs that the State may allocate among proposed projects that are designed to earn LIHTCs. In general, regardless of how large a building's qualified basis may be, the LIHTCs that the owner may earn from the building are limited by the amount that the State has allocated. Each State (including any Agencies) must adopt a qualified allocation plan (QAP) to guide the allocation.

A QAP must give preference to projects serving the lowest income tenants, to projects obligated to serve qualified tenants for the longest periods, and to projects which are located in QCTs and the development of which contributes to a concerted community revitalization plan. In addition, the Code prescribes ten selection criteria that every QAP must include—project location, housing needs characteristics, project characteristics (including whether the project includes the use of existing housing as part of a community revitalization plan), sponsor characteristics, tenant populations with special housing needs, public housing waiting lists, tenant populations of individuals with children, projects intended for eventual tenant ownership, the energy efficiency of the project, and the historic nature of the project. A QAP must also provide a procedure that the Agency (or its agent) will follow in monitoring for noncompliance with the rules for LIHTC eligibility and in notifying the IRS of any noncompliance of which the Agency has become aware.

None of these criteria or factors, however, unambiguously requires States to allocate housing credit dollar amounts in a manner that affirmatively furthers fair housing, even though Federal agencies administering housing programs or activities are subject to such a requirement.

Private activity bonds

In general, gross income does not include interest on any State or local bond if the bond is a qualified private activity bond (PAB). One of the requirements to be a qualified PAB is that the bond generally needs to be part of an issue whose face amount, together with the face amount of other PABs issued by the issuing authority in the calendar year, does not exceed the maximum amount of PABs that the authority may issue for the year (referred to as the "PAB volume cap"). Every year, the Code allows each State a limited amount of PAB volume cap.

In addition to earning LIHTCs as a result of receiving a State allocation of LIHTCs, a building owner can generate LIHTCs by financing the building with qualified PABs. Without any State allocation, LIHTCs may be earned on the full qualified basis of a building if the qualified PABs finance at least half of the aggregate basis of the building and the land. In the case of these bond-derived credits, however, the credit rate is the 30-percent present value credit rate, not the 70-percent present value credit rate (or, when applicable, at the 9-percent minimum rate), which generally applies to State-allocated credits. Bond-derived credits do not reduce the State's remaining allocable LIHTCs.

Protection against domestic abuse

LIHTCs support the construction and preservation of a large portion of the nation's affordable housing for people of limited means. LIHTCs differ, however, from Federal housing programs in its combination of the following attributes: (1) the housing itself is owned and managed by private-sector persons; (2) these persons are answerable in the first instance to State authorities (which are responsible for monitoring compliance with Federal requirements); and (3) the Federal role (undertaken by the IRS) is to determine whether the owners are entitled to tax credits.

Section 601 of the Violence Against Women Reauthorization Act of 2013 provides that applicants or tenants of certain federally assisted housing may not be denied admission to, denied assistance under, terminated from participation in, or evicted from, the housing on the basis that the applicant or tenant is or has been a victim of domestic violence, dating violence, sexual assault, or stalking (collectively, "domestic abuse"). In appropriate cases, a lease may be bifurcated to evict or otherwise remove the perpetrator of criminal domestic abuse and yet to avoid penalizing a victim of that abuse who is a lawful occupant. That section applies these duties to "the low income housing tax credit program under section 42 of the Internal Revenue Code of 1986."

Reasons for Change

Agencies in charge of allocating LIHTCs are often confronted with a larger number of deserving projects than they can support. Some of these buildings can be built only with higher credit rate LIHTCs. Increasing the volume of higher rate credits would allow the development of some projects for which the current supply is insufficient. In addition, some developers obtain LIHTCs by financing their buildings with PABs even though they have access to more preferred

financing options. The resulting transaction costs consume resources that might otherwise provide affordable housing.

In practice, the income criteria often produce buildings that serve a narrow income band of tenants—those just below the eligible income threshold. Without incentives to create mixed-income housing, LIHTC-supported buildings may not serve those most in need. In addition, the inflexibility of the income criteria makes it difficult for LIHTC to support acquisition of partially or fully occupied properties for preservation or repurposing.

LIHTCs are the Federal Government's largest vehicle supporting the construction and rehabilitation of affordable housing. Because Federal law has made State agencies responsible for allocating the potential to earn LIHTCs, there should be no doubt that these agencies must do so in a manner that affirmatively furthers fair housing.

Preservation and rehabilitation of existing affordable housing is often a more efficient way of supplying affordable housing than is new construction. In addition, public resources may have already been expended in the development of existing affordable housing. Thus, preservation of publicly assisted affordable housing should be encouraged.

Because of the population cap on census tracts in an MSA that may be designated as QCTs, some tracts with qualifying levels of poverty or low income residents may be kept from QCT status by the presence of similarly distressed areas in the same MSA. Nearby poverty should not bar an otherwise-eligible poor census tract from qualifying for increased subsidies.

Although the Violence Against Women Reauthorization Act of 2013 provides that no building that has produced LIHTCs for its owner should fail to provide reasonable protections for victims of domestic abuse, it does not amend the Code, nor does it contain any provision for enforcing those protections in LIHTC buildings.

Proposal

Allow conversion of private activity bond volume cap into LIHTCs

The proposal would provide two ways in which PAB volume cap could be converted into LIHTCs.

First, States would be authorized to convert PAB volume cap to be received for a calendar year into LIHTC allocation authorization applicable to the same year. The conversion ratio would be reset each calendar year to respond to changing interest rates. In addition, each State would be subject to an annual maximum amount of PAB volume cap that can be converted.

For each $1,000 of PAB volume cap surrendered, the State would receive additional allocable LIHTCs for the calendar year equal to: $1000 × twice the applicable percentage that applies for PAB-financed buildings and that is determined under section 42(b)(1)(B)(ii) for December of the preceding calendar year.

The aggregate amount of PAB volume cap that each State may convert with respect to a calendar year is 18 percent of the PAB volume cap that the State receives for that year under section 146(d)(1).

The proposal would be effective with respect to PAB volume cap to be received in, and additional LIHTC allocation authority received for, calendar years beginning after the date of enactment.

Second, instead of obtaining the lower-rate credits by financing at least 50 percent of a building with PABs, a taxpayer could obtain these credits by satisfying the following requirements: (1) there is an allocation of PAB volume cap in an amount not less than the amount of bonds that would be necessary to qualify for LIHTCs and (2) the volume cap so allocated reduces the State's remaining volume cap as if tax-exempt bonds had been issued.

The proposal would be effective for projects that are allocated volume cap after the date of enactment.

Encourage mixed income occupancy by allowing LIHTC-supported projects to elect a criterion employing a restriction on average income

The proposal would add a third criterion to the two section 42(g)(1) criteria that are described above. When a taxpayer elects this third criterion, at least 40 percent of the units in the project would have to be occupied by tenants with incomes that average no more than 60 percent of AMI. No rent-restricted unit, however, could be occupied by a tenant with income over 80 percent of AMI; and, for purposes of computing the average, any unit with an income limit that is less than 20 percent of AMI would be treated as having a 20-percent limit. Maximum allowable rents would be determined according to the income limit of the unit. A project would satisfy the third criterion only if the average income of the units is no more than 60 percent of AMI both (1) calculated with all low-income units weighted equally; and (2) calculated with each low-income unit weighted according to imputed LIHTC occupancy rules, i.e., 1.5 occupants per bedroom and one occupant for zero-bedroom units).

For example, suppose that a project has 70 identical rent-restricted units—10 units with income limits of 20 percent of AMI, 10 with limits of 40 percent of AMI, 20 with limits of 60 percent of AMI, and 30 with limits of 80 percent of AMI. This would satisfy the new criterion because none of the limits exceeds 80 percent of AMI and the average does not exceed 60 percent of AMI. ($10\times20 + 10\times40 + 20\times60 + 30\times80 = 4200$, and $4200/70 = 60$.) (Because all of the units are identical, when the average is calculated weighting each unit by its imputed occupancy, the weighted average is also 60.)

A special rule would apply to rehabilitation projects that contain units that receive ongoing subsidies (e.g., rental assistance, operating subsidies, and interest subsidies) administered by HUD or the Department of Agriculture. If a tenant, when admitted to such a property, had an income not more than 60 percent of the then-applicable AMI and if, when the tenant's income is measured for purposes of LIHTC qualification, the tenant's income is greater than 60 percent of the now-applicable AMI but not more than 80 percent of AMI (this fraction is called the "Credit-

Year-1 AMI Percentage"), then, the taxpayer may make an election that would allow the tenant to remain in residence without impairing the building's LIHTCs. In particular, the election would have the following consequences: (1) the average-income calculations would be made without taking that tenant's unit into account; (2) the requirement in the next-available-unit rule, *see* section 42(g)(2)(D)(ii), would apply; and (3) the tenant's unit would be treated as rent-restricted if the gross rent collected from the unit does not exceed 30 percent of the Credit-Year-1 AMI Percentage multiplied by the current AMI.

When the tenant moves out, if the unit is to continue to be rent-restricted, the income restriction on the unit would revert to 60 percent of AMI (or whatever other level the taxpayer determines, consistent with the criterion that was elected under section 42(g)(1)).

The proposal would be effective for elections under section 42(g)(1) that are made after the date of enactment.

Add furthering fair housing and preservation of publicly assisted affordable housing to allocation criteria

The proposal would add a fourth required allocation preference to clarify States' responsibilities to make allocations in a manner that affirmatively furthers fair housing. The proposal would also add preservation of publicly assisted affordable housing as an eleventh selection criterion that QAPs must include.

The proposal would be effective for allocations made in calendar years beginning after the date of enactment.

Remove the QCT population cap

The proposal would allow HUD to designate as a QCT any census tract that meets the current statutory criteria of a poverty rate of at least 25 percent or 50 percent or more of households with an income less than 60 percent of AMI. That is, the proposal would remove the current limit under which the aggregate population in census tracts designated as QCTs cannot exceed 20 percent of the metropolitan area's population.

This change would apply to buildings that receive allocations of LIHTCs or volume cap after the date of enactment.

Implement requirement that LIHTC-supported housing protect victims of domestic abuse

Protections for victims of domestic abuse would be required in all Long-Term-Use Agreements. These provisions would apply to both the low-income and the market-rate units in the building. For example, once such an Agreement applies to a building, the owner could not refuse to rent any unit in the building to a person because that person had experienced domestic abuse. Moreover, such an experience of domestic abuse would not be good cause for terminating a tenant's occupancy. Under the Agreement, an owner could bifurcate a lease so that the owner could simultaneously (1) remove or evict a tenant or lawful occupant who engaged in criminal

activity directly relating to domestic abuse and (2) avoid evicting, terminating, or otherwise penalizing a tenant or lawful occupant who is a victim of that criminal activity. The proposal would clarify that such a continuing occupant of a low-income unit could become a tenant and would not have to be tested for low-income status as if the continuing occupant were a new tenant.

Any prospective, present, or former occupant of the building could enforce these provisions of an Agreement in any State court, whether or not that occupant meets the income limitations applicable to the building.

In addition, the proposal would clarify that occupancy restrictions or preferences that favor persons who have experienced domestic abuse would qualify for the "special needs" exception to the general public use requirement.

The proposed requirements for Long-Term-Use Agreements would be effective for Agreements that are either first executed, or subsequently modified, 30 days or more after enactment. The proposed clarification of the general public use requirement would be effective for taxable years ending after the date of enactment.