AFFORDABLE RENTAL HOUSING A.C.T.I.O.N.
A Call To Invest in Our Neighborhoods

Low-Income Housing Tax Credit
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I. HOW THE HOUSING CREDIT WORKS

What is the Low-Income Housing Tax Credit (Housing Credit)?
The Housing Credit provides the private sector with an incentive to invest in affordable rental housing for low-income families. Since President Reagan signed it into law in 1986, the Housing Credit has financed the construction and preservation of more than 3 million affordable rental homes nationwide, at a rate of nearly 100,000 per year. Today it produces virtually all new affordable rental housing and is our primary tool for preserving existing affordable rental housing.

How does the Housing Credit work?
The federal government issues Housing Credit authority to states based on their populations. In 2018, states will receive the greater of $2.70 per capita or $3.105 million. In addition, affordable housing developments financed with tax-exempt Private Activity Bonds are eligible for Housing Credits. Roughly half of Housing Credit developments receive "allocated" Housing Credits and the other half receive Housing Credits by way of bond financing.

Each year, state allocating agencies establish criteria for awarding credits (known as a Qualified Allocation Plan, or QAP) that address the state's local housing needs and priorities, subject to broad federal guidelines and after receiving public comment. Developers submit applications for credit authority through a highly competitive process; each year, allocating agencies receive applications requesting two to three times more Housing Credits than the agencies have to allocate. Housing Credits are then awarded to developers based on how well their proposed projects meet the criteria established in the QAP.

State allocating agencies underwrite every Housing Credit property to ensure that each development receives only the amount of Housing Credits necessary to ensure its financial feasibility, while avoiding over-subsidization. The agencies consider all sources and uses of funds, the length of the affordability period, the market price for tax credits, and the expected operating expenses to determine the Housing Credit amount for each property.

Developers exchange the ten-year stream of Housing Credits for up-front equity capital from investors. The equity capital enables the property to be financed with lower levels of debt, which makes it possible to offer apartments to low-income residents at rents they can afford. The annual credit percentage is determined by the type of development – there is a "9 percent" credit for new construction and substantial rehabilitation, and a "4 percent" credit for acquisition and rehabilitation, described in greater detail below.

At a minimum, at least 20 percent of the apartments in a Housing Credit property must be targeted to residents at or below 50 percent of area median income (AMI), or 40 percent of the apartments must be targeted to residents at or below 60 percent of AMI. The amount of Housing Credit authority for which the property is eligible depends on the proportion of the apartments in the property that are reserved for low-income households and rented at affordable rates. In practice, many developers target nearly all of the apartments in these properties to low-income tenants. The low-income residents pay 30 percent of the income threshold as rent.

It is only after the property is constructed, meets all federal requirements, and is occupied by income-eligible tenants paying affordable rents that an investor can begin claiming the tax credits. In the rare case that a property falls out of compliance at any time over the next fifteen years, credits are subject to recapture. The private sector, not taxpayers, bear the financial risk. The property is also subject to continued affordability restrictions enforced by the states for at least another 15 years, though many states impose even longer affordability periods.

What are Tax-Exempt Multifamily Housing Bonds (Housing Bonds)?
Multifamily Housing Bonds, a category of private activity bonds, are a tax-exempt financing tool issued by states and local governments to enable the acquisition, construction, and rehabilitation of multifamily housing for low-income renters. When 50 percent or more of a property is financed using multifamily Housing Bonds, that property becomes eligible to receive "4 percent" Housing Credits, which provide a shallower subsidy that is generally used for preservation and rehabilitation of existing properties. The 4 percent Credit is especially important to recapitalizing existing public housing through the Rental Assistance Demonstration (RAD) and preserving other federal investments through HUD and USDA rural rental housing. About half of all Housing Credit apartments produced each year are financed with "4 percent" Housing Credits and Housing Bonds.

Investors in multifamily Housing Bonds are willing to accept a lower yield than they would get on taxable bonds because the interest on the investment is exempt from federal income tax. The tax exemption allows developers to access debt at a lower interest rate than would be available with conventional financing. In 2018, states will receive the greater of $105 per capita or $311 million in private activity bond authority.

Like other Housing Credit properties, Housing Bond-financed Housing Credit developments must comply with the state's allocation plan established in the QAP and with all other applicable Housing Credit program rules, including those related to income targeting and the affordability period.

Who does the Housing Credit serve?
In order to move into a Housing Credit development, residents must earn at or below 60 percent of AMI, but many Housing Credit developments serve much lower-income tenants. In fact, federal tax credit statute explicitly requires that each state's QAP must give preference to "projects serving the lowest income tenants… for the longest period of time." The most recent HUD Housing Credit tenant study, released in 2018, found nearly half of all reported Housing Credit renters earn at or below 30 percent of AMGI (44.5 percent), and nearly four in five (78.7 percent) are very low-income, meaning they have household incomes at or below 50 percent of AMGI.

The Housing Credit also serves communities with particularly acute affordable housing needs, including veterans, seniors, Native Americans, people with disabilities, and rural communities.

How do states provide oversight and prevent against fraud?
As directed by Congress, state allocating agencies are responsible for providing oversight of the Housing Credit program and working closely with the IRS to monitor project compliance. State agencies regularly conduct reviews of Housing Credit developments to inspect their physical and financial condition, certify their occupancy by qualified low-income residents, and ensure overall compliance with federal rules.

A recent GAO study of state agencies' administration of the program found that states often go above and beyond the compliance monitoring responsibilities required of them by law. Multiple parties – both public and private – scrutinize each transaction from beginning to end, providing independent checks and balances, and tenants have full enforcement rights as well. Because the Housing Credit is a pay-for-performance credit that subjects equity investors to forfeiture of the tax benefits if properties are not in compliance with the law, Housing Credit properties are subject to vigilant private sector oversight. The record of states monitoring for compliance is strong and the affordable housing community supports all efforts to investigate and vigorously prosecute any violations.

How does the cost of building Housing Credit properties compare to other types of housing?
Comparing the cost of developing Housing Credit properties to market-rate multifamily housing is difficult for a number of reasons. For example, many single family home builders are able to take advantage of processes not available in any multifamily construction. Also, market-rate apartments often have greater efficiencies of scale due to placing more units on a site. Another crucial difference is the limited rent growth means less ability to replace components over time, creating an incentive to use higher-quality, longer-lasting materials. Despite all of these factors there is no evidence of Housing Credit properties costing more to build than other apartment complexes.

II. THE NEED FOR THE HOUSING CREDIT

Why does the federal government need to invest in affordable housing?
America faces a severe and growing shortage of affordable rental housing. According to the 2017 "State of the Nation's Housing" report from the Harvard Joint Center on Housing Studies (JCHS), more than a quarter of all renters – over 11 million households – are "severely rent burdened," meaning they pay more than half of their income on rent. This creates financial instability and puts households at risk of eviction and homelessness in the face of unforeseen expenses. Fewer than one in four households eligible for federal housing assistance actually receives it, and there are scarce affordable options available in the private market.

The rental housing crisis will likely grow. Analysts expect an average of over 400,000 new households – many of whom will be low-income – to enter the rental housing market each year over the next decade. However, the rental housing industry develops less than this number of new rental homes each year, and mostly on the higher end of the market. Meanwhile, hundreds of thousands of affordable homes are lost each year to rent increases or obsolescence. According to estimates from Enterprise Community Partners and JCHS, the number of severely rent burdened households will rise by 11 percent to 13.1 million in 2025, up from 11.8 million in 2015.

If there is so much demand for affordable housing, why doesn't the private sector provide it?
The economics of rental housing development make it financially infeasible to build affordable housing without a subsidy such as the Housing Credit. The Housing Credit enables developers to raise equity capital from investors, which reduces the debt on properties, enabling lower rents. According to JCHS, "to develop new apartments affordable to renter households with incomes equivalent to the full-time minimum wage, the construction costs would have to be 28 percent of the current average" – essentially making the financing impossible.

Why do we need to build affordable housing – can we just use housing vouchers?
The affordable housing crisis our nation faces is multifaceted, thus the Housing Credit and vouchers have been designed to play different and complementary roles in our nation's response to that crisis. Indeed, the Housing Credit is often creatively combined with resources from other housing programs, including vouchers, to create better outcomes than is possible with just one affordable housing tool.

Vouchers are one of the primary vehicles for providing affordable housing choices to extremely low-income families, especially in low-cost housing markets. However, in many markets, voucher holders struggle to find apartments that are within HUD's voucher payment standard and for which landlords will accept a voucher as payment. This problem is especially acute in tight housing markets with low vacancy rates and rapidly escalating rents.

The Housing Credit, on the other hand, expands and preserves the affordable housing stock as a long-term community asset. It provides more apartment homes in areas that lack the affordable housing to meet

community housing needs, and it supports the revitalization of communities through new investment. The Housing Credit also produces housing that incorporates targeted services, such as supportive housing for veterans, seniors, people with disabilities, the chronically homeless, and foster youth. Vouchers, though extremely important, are not designed to achieve these objectives. Likewise, it can be difficult for the Housing Credit, as a capital subsidy, to ensure that apartments are affordable to the very lowest income renters. Thus the Housing Credit and vouchers are often used together to address the spectrum of housing needs: the Housing Credit to build new and preserve existing affordable housing on a long-term basis, and the voucher to enable those already low-cost apartments to be more affordable to the lowest income tenants.

How does the Housing Credit impact surrounding neighborhoods?
The Housing Credit supports economic growth in communities and surrounding neighborhoods in a number of ways. The National Association of Home Builders (NAHB) estimates the Housing Credit adds $9.1 billion in income to the economy and generates approximately $3.5 billion in federal, state, and local taxes each year. Housing Credit development also supports jobs – roughly 1,130 for every 1,000 Housing Credit apartments developed, according to NAHB. This amounts to roughly 96,000 jobs per year, and more than 3.25 million since the program was created in 1986, across a diverse range of industries, including the manufacturing of lighting and heating equipment, lumber, concrete, and other products, as well as jobs in transportation, engineering, law, and real estate.

Conversely, a lack of affordable housing negatively impacts economies. Research shows that high rent burdens have priced out many workers from the most productive cities, resulting in 13.5 percent foregone GDP growth, a loss of roughly $1.95 trillion, between 1964 and 2009.

Housing Credit development also positively impacts neighborhoods in need of renewal. About one-third of all Housing Credit properties help revitalize distressed communities. Stanford University research shows that Housing Credit investments improve property values and reduce poverty, crime, and racial and economic isolation, generating a variety of socio-economic opportunities for Housing Credit tenants and neighborhood residents.

How does the Housing Credit reduce spending on other government programs?
Housing Credit development can also help reduce government costs and save taxpayer money. A report from the Bipartisan Policy Center, "Building the Case: Low-Income Housing Tax Credits and Health," found that when affordable housing is coupled with supportive services, such as those targeted to assist the chronically homeless, those living with serious mental illness, and veterans, it can lead to significant public savings in shelter costs, the criminal justice system, and health care costs. One study of a pilot program in Ohio found that supportive housing saved an average of over $6,000 a year per person in health care.

III. PROPOSALS TO STRENGTHEN AND EXPAND THE HOUSING CREDIT

What is the Affordable Housing Credit Improvement Act?
The Affordable Housing Credit Improvement Act is bipartisan legislation that would make numerous modifications to strengthen the Housing Credit by providing states with additional flexibility, making the financing of affordable housing more predictable and streamlined, facilitating Housing Credit development in challenging markets like rural and Native American communities, increasing the Housing Credit's ability to serve extremely low-income tenants, and supporting the preservation of existing affordable housing. The Senate version of the bill would also increase the annual Housing Credit allocation by 50 percent, phased in over five years, to make a meaningful step towards addressing our nation's severe shortage of affordable rental housing. The legislation was introduced in the Senate (S. 548) by Senator Maria Cantwell (D-WA) and Senate Finance Committee Chairman Orrin Hatch (R-UT), and in the House (H.R. 1661) by

Representative Pat Tiberi (R-OH-12) and Ways and Means Committee Ranking Member Richard Neal (D-MA-1). With Rep. Tiberi leaving Congress at the beginning of 2018, Rep. Carlos Curbelo (R-FL-26) has assumed the role of lead House sponsor. Read a summary of the Senate bill and the House bill.

Is there enough developer demand to absorb a significant increase in Housing Credits?
Yes. In 2015 – the most recent year for which data is available – state Housing Credit allocating agencies received applications requesting nearly three times their available Housing Credit authority. Many more potential applications for worthy developments are not submitted in light of the program's intense competition, suggesting the demand may be even broader.

What does the Housing Credit cost? What would it cost to expand it by 50 percent?
According to the congressional Joint Committee on Taxation (JCT), the Housing Credit currently costs roughly $8 billion per year in foregone revenue, which includes the cost of credits that have been issued in prior years. The JCT estimates that a 50 percent expansion of the Housing Credit phased in over five years would cost roughly $4.1 billion over the next ten years.

How was the Housing Credit improved by the Consolidated Appropriations Act of 2018?
The fiscal year (FY) 2018 omnibus spending bill, the Consolidated Appropriations Act of 2018, included two critical provisions from the Affordable Housing Credit Improvement Act to expand and strengthen the Housing Credit: (1) a temporary increase in Housing Credit volume cap and (2) income averaging as a new minimum set-aside election.

The bill provided a 12.5 percent increase in state Housing Credit authority for four years beginning in 2018 (2018-2021). In each of those years, the per capita volume cap and state minimum that otherwise would have been in effect is multiplied by 1.125. The cap increase is an increase in Housing Credit authority for allocated Credits (applying to the 9 percent Credit and the 4 percent Credit for acquisition; it is not an increase in 4 percent Credit equity for bond-financed developments, which are not limited by the Housing Credit volume cap). It is a flat 12.5 percent increase for each of the applicable years, *not* an additive increase in which each successive year would receive 12.5 percent more Credit authority than the previous year. The cap increase in the FY 2018 omnibus spending bill will increase production by an estimated 28,4000 affordable rental homes over 10 years and takes a major step towards achieving the 50 percent phased in cap increase included in S. 548, the Affordable Housing Credit Improvement Act.

The bill also permanently established a third minimum set-aside election option for new Housing Credit developments, which developers can choose in lieu of the two previously existing minimum set-aside elections (at least 40 percent of the units in a development limited to households earning no more than 60 percent of Area Median Income (AMI) or at least 20 percent of the units in a development limited to households earning no more than 50 percent of AMI). Instead, income averaging would allow Credit-qualified units to serve households earning as much as 80 percent or less of AMI, so long as the average income limit in the property is 60 percent or less of AMI. Developers electing income averaging would need to commit to having at least 40 percent of the units in the property affordable to eligible households. The 80 percent of AMI standard is consistent with long-standing federal affordable housing policies, which define low-income as households earning no more than 80 percent of AMI.

Under the income averaging option, the higher rents that households with incomes in the 61-80 percent of AMI range could pay would have the potential to offset the lower rents for extremely low- and very low-income households living in the property in units designated at lower income levels, thereby allowing developments to maintain financial feasibility while providing a deeper level of affordability than is currently possible without other subsidies. Income averaging thus preserves rigorous targeting to low-income households, while providing more flexibility to the program and greater income-mixing potential. Income averaging applies to the designated income levels of the units in a development, not the

income of the individual tenant households in a development. Income averaging is a provision in both the Senate (S.548) and House (H.R. 1661) versions of the Affordable Housing Credit Improvement Act.

IV. TAX REFORM'S IMPACT ON THE HOUSING CREDIT

How was the Housing Credit impacted by the Tax Cuts and Jobs Act?

On December 22, 2017, President Trump signed the "Tax Cuts and Jobs Act", H.R. 1, into law. The bill retained the Housing Credit as well as private-activity bonds, including multifamily Housing Bonds, which together finance virtually all affordable housing in the U.S. While it is critical that both core affordable housing financing tools remained intact, affordable housing will still be significantly impacted by the decrease in the top corporate tax rate from 35 to 21 percent, since a substantially lower corporate rate reduces the value of the Housing Credit to investors, which decreases the amount of equity leveraged by the Housing Credit and ultimately overall production.

According to an estimate by accounting firm Novogradac and Company, the lower corporate rate and the change in the annual inflation factor for state Housing Credit allocations and private activity bonds volume caps will reduce our future supply of affordable homes by roughly 235,000 over the next ten years. The provision in the Affordable Housing Credit Improvement Act that would increase the Housing Credit allocation by 50 percent would offset this reduction.

The bill also created a base erosion and anti-abuse tax (BEAT), which will prevent certain U.S. corporations with a foreign parent or affiliate from receiving the full value of Housing Credit investments and may cause some Housing Credit investors to exit the market as well as offload a portion of their portfolio on the secondary market, further depressing investment and affordable housing production.

Lastly, the bill enacted a shift to a "chained" consumer price index (CPI), which will decrease inflation adjustments in Housing Credit and private activity bond allocations, and affect the minimums small states can receive. It is to be determined whether per capita rates will also be altered.