1 Introduction

Reason for Reading

This book is intended for professionals who are *beginning* the process of learning about the federal low-income housing tax credit (Housing Credit, also known as LIHTC).[1] Even the most capable student cannot obtain a working knowledge by reading one or even several publications on the subject. The rules and practices are too complex, particularly those governing compliance. But every journey starts somewhere, and this book will help with your first application/allocation/closing/property—whichever role brings you to this industry.

How to Use This Book

Unlike some publications, which serve more as references, this book is designed to be read from beginning to end. While admittedly not a gripping narrative, there is a flow—you also should avoid skipping ahead. The sidebars provide verbal oases, plus there are a few weak attempts at humor randomly sprinkled throughout.

Unfortunately, one of the many challenges of learning this program is circularity: in order to fully understand Concept X, you need to first grasp Concept Y, but Y also is necessary to understand X. Of course, an explanation can only address topics one at a time. As a result, there's a need for statements such as "Remember when we covered X? Well, here it is again." You will need to be patient, accept that not all of it will make sense right away, and possibly reread certain parts.

Last, the book has no glossary, though there is an index. The reason for not including a glossary is that the key terms are described in a context that is essential for understanding what they mean. Having proper, complete definitions would result in essentially restating much of the book.

The Really Basic Basics

What is the Housing Credit? The technical answer is Section 42 of the Internal Revenue Code, plus various regulations, rulings, notices, etc., from the Internal Revenue Service (IRS, the first of two curiously interchangeable uses for this acronym). Some of these incorporate provisions from other authorities, particularly those issued by the U.S. Department of Housing and Urban Development (HUD).

From a practical perspective, the Housing Credit is America's only remaining affordable rental housing production program of any material scale. Since being enacted as part of tax reform in 1986 (see Sidebar 1: Early History), Housing Credits have been responsible for building or rehabilitating over 3.13 million apartments across the country and adding over 100,000 units every year.[2] As such, the program contributes a material percentage of all multifamily construction.[3]

The Housing Credit is an upfront capital subsidy, as opposed to ongoing operating or payment assistance (Section 8 is an example of the latter). All of the units are rented—there is no occupancy by owners. Corporations invest equity, which greatly reduces the amount of private- or public-sector financing necessary for construction. The result is lower debt service, which allows for affordable rents. The investor benefits by receiving a credit against its tax liability.

The buildings may take any form, from rural single-family houses to downtown high-rises. The real estate is owned by a limited liability company or limited partnership (known as a pass-through entity). Developers and investors are the members/partners of these entities.

Sidebar 1: Early History

by Robert Rozen

Robert Rozen is an affordable housing industry consultant. Prior to joining the private sector, he served for many years in various staff positions in the U.S. Senate, including as Legislative Counsel to Senator George Mitchell.

The Housing Credit was enacted as part of the Tax Reform Act of 1986 as a means of more tightly tying the provision of housing tax subsidies to the benefit provided to tenants in the form of lower rents. Prior affordable housing tax incentives had a poor reputation, were primarily utilized by individuals, and did not do a good job of matching up the benefit to investors with the benefit to tenants. The Housing Credit was created in 1986 as a temporary three-year program without a lot of forethought. It originated in the Senate Finance Committee and underwent considerable changes on the Senate floor. The concept was embraced by the House of Representatives in conference with the Senate and was included in the final bill, but with little industry optimism that it would be an effective means of developing affordable housing.

Following its enactment, Senators George Mitchell (D-Me.) and John Danforth (R-Mo.) put together a task force of industry participants that prepared a report recommending changes in the law. This resulted in legislation that was enacted in 1989 and that included a number of changes to the law to tighten the program rules to ensure a good public policy result. Perhaps the most important change required states to establish qualified allocation plans (QAPs) where the affordable housing needs of each state are identified through public hearings. Developers compete against each other to receive allocations based on how well they propose to serve the housing priorities identified in the allocation plan. The 1989 changes also established limitations on back-end appreciation potential to

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Sidebar 1: Early History *Continued*

investors from the property. Incentives were also created to target tenant populations well below 60 percent of area median income (AMI) and to commit the property to longer-term use restrictions. Extra tax credits were provided for development in the most difficult, low-income areas.

In 1993, after a series of one-year extensions, the program was made permanent. As corporate investors became confident of the continued existence of the program, they were willing to devote more resources to maintaining an ongoing staff, and this considerably raised the level of corporate demand for tax credits, causing prices to rise and investor returns to fall.

In 1995, Chairman Bill Archer proposed sunsetting the Housing Credit, which caused the industry to put together a major effort to save the program. Archer settled for a General Accounting Office study, which, when it came out in 1997, presented a very favorable picture of a successful and efficient program. At about the same time, the IRS established a special program to audit Housing Credit partnerships and investors to determine compliance with the program. This special audit program was later disbanded when the IRS found a very low level of noncompliance. In 2002, Ernst & Young issued the first of several reports finding superior operating performance by the thousands of properties financed since the beginning of the program. These reports—most recently authored by CohnReznick—have found a cumulative foreclosure rate of less than 1 percent.[4] These extraordinary results have helped minimize risk premiums and caused investors to accept lower rates of return, which enhance program efficiency.

In 2003, the industry mounted a major effort to deal with a potential disaster from President Bush's proposal to eliminate taxation of dividends. The original proposal would have made dividends exempt from taxation except to the extent that companies used tax expenditures to reduce their tax liability. That approach to dividend relief—which would have significantly reduced returns from Housing Credit investments—was ultimately rejected by Congress, at least in part due to the concerns of the affordable housing industry.

After several years of industry examination of the program, the chairman of the Ways and Means Committee, Charlie Rangel (D-N.Y.), advanced legislation making nearly two dozen changes to the Housing Credit that were enacted into law as part of the Housing and Economic Recovery Act of 2008.

The Housing Credit survived the 2008–2009 financial crisis in good health. Although there was considerable short-term turmoil in the Housing Credit equity markets, largely due to the loss of Fannie Mae and Freddie Mac as investors, property performance remained strong with very low vacancy rates and solid balance sheets.

More recently, while the 2017 tax cut bill did not include any direct assaults on the Housing Credit program, the reduction in the top corporate tax rate from 35 percent to 21 percent significantly undermined credit pricing. Shortly thereafter, Congress showed its support for the program with a four-year, 12.5 percent increase in the allocated credit cap. Today, Congress is considering bipartisan legislation to further increase the cap and make a number of other changes to strengthen the program and expand its ability to address the affordable housing needs of the nation.

Although a federal resource, the Housing Credit is administered at the state level (and a few localities) by allocating agencies. The rules for distribution and compliance are contained in a document called the qualified allocation plan (QAP). The amount available is usually described as $2.70 multiplied by a state's population,[5] but the real figure is actually ten times higher (which is explained later on).

Once built, the units must comply with requirements regarding household ***I***ncome, the ***R***ent charged, and ***S***uitability of the property (the other IRS) for at least 30 years. The income and rent limits reflect anywhere from 20 to 80 percent of the AMI. Management companies are responsible for properties following these rules, and allocating agencies monitor for compliance.

Fear not, the preceding is just a warm-up—these topics and more will be covered in greater detail.

One of the most uniquely compelling aspects of the Housing Credit program is how both the bottom line and policy considerations always matter. Sometimes the two are in conflict, other times they are complementary. Either way it makes the work endlessly fascinating.

Two Different Communities

Every field has divisions that are imperceptible to outsiders. For example, most people think of all geologists as experts in rocks when, in fact, there's a clear (and sometimes bitter) split between igneous and sedimentary specialists.

The Housing Credit industry is no exception. You may be thinking either applicants/agencies or developers/investors. While those distinctions exist, the main division is between development and compliance—in other words, those responsible for a project being built versus those responsible for the work done after it is in operation. This split between roles applies to most types of participants and usually defines the organizational structure.

While the differences are understandable, there also are many areas of overlap. More importantly, each side needs to know what is significant to both. A mistake by one can be disastrous for the other.

Limitations and Disclaimers

In a publication written by a lawyer and published by the American Bar Association (ABA), limitations and disclaimers should be no surprise.

1. Nothing contained in this book is meant as legal or other professional advice. A crucial early step in Housing Credit development, finance, operations, or administration is working with the right attorney and accountant (even if you are one but not in this field). This book is no substitute for consulting with your lawyer, but it should help you better understand what he or she has to say.
2. Since this book is limited to the basics, many concepts are not fully addressed or, in some cases, not mentioned at all. (Think of these as fun surprises for the future.) In contrast, for example, one comprehensive reference publication is more than 900 pages long.[6] The most frequently omitted subjects are exceptions to the stated rule and exceptions to the exceptions. (Yes, there are several instances of the latter. Again, this is a very complex program; remember it is governed by the IRS!)
3. What you are reading is a snapshot, a point-in-time description. The rules will change, possibly even while these pages are at the printer. You will need to find ways to keep up to date. The best method is to subscribe to trade industry publications, or at least their free broadcast emails (see Sidebar 2: Trade Industry Resources for more information).
4. Everything contained in this publication is the position of the author alone. None of the statements are attributable to any current, past, or future employer.
5. Finally, the narrative assumes readers are somewhat familiar with real estate development, finance, and/or property management. If this does not describe you or someone on your team, then Housing Credits may be too much of a stretch.

Sidebar 2: Trade Industry Resources

By Emily Cadik

Emily Cadik is the Executive Director of the Affordable Housing Tax Credit Coalition (AHTCC), where she leads advocacy to support affordable rental housing financed using the Housing Credit. Prior to joining the AHTCC, she was a Senior Director of Public Policy at Enterprise Community Partners. She also helped to lead the A Call To Invest in Our Neighborhoods (ACTION) Campaign.

ACTION (A Call To Invest in Our Neighborhoods) Campaign

http://www.rentalhousingaction.org/

A national grassroots coalition of over 2,200 national, state, and local organizations and businesses calling on Congress to protect, expand, and strengthen the Housing Credit. The ACTION Campaign's Advocacy Toolkit provides a full suite of materials to make the case for the Housing Credit.

Affordable Housing Tax Credit Coalition

http://taxcreditcoalition.org/

A trade association of syndicators, developers, investors, lenders, nonprofit groups, public agencies, and others advocating on behalf of the Housing Credit through legislative outreach and education. Since 1988, the AHTCC has been at the forefront of all efforts to expand, strengthen, and protect the Housing Credit.

Affordable Housing Finance (AHF)

http://www.housingfinance.com/

AHF provides updates on the latest news and trends related to financing, developing, and operating affordable housing.

Novogradac Affordable Housing Resource Center
https://www.novoco.com/resource-centers/affordable-housing-tax-credits
Provides up-to-date national news for the Housing Credit industry; a compilation of relevant Housing Credit guidance; links to podcasts, blog posts, and articles; state agency information; relevant data/research; and more.

National Association of Home Builders (NAHB), Housing Credit Group
https://www.nahb.org/en/members/committees-and-councils/Councils/multifamily-council/housing-credit-group.aspx
NAHB is a trade association representing 140,000 members that develop roughly 80 percent of the new homes built in the United States, including affordable multifamily housing. The Housing Credit Group is an organization of professionals engaged in the development of affordable rental housing using the Housing Credit; it leverages the NAHB's political power to support its members.

National Council of State Housing Agencies
https://www.ncsha.org/
A nonprofit, nonpartisan organization created to advance, through advocacy and education, the efforts of the nation's state housing finance agencies and their partners to provide affordable housing to those who need it. Members include Housing Credit allocating agencies and more than 300 affiliates in the affordable housing community.

Tax Credit Advisor
https://www.housingonline.com/tax-credit-advisor/
This monthly publication provides information and analysis to successfully develop, finance, manage, and invest in tax credit projects.

Endnotes

1. See Epilogue for potential changes from pending legislation.

2. *Low-Income Housing Tax Credits*, HUD User, https://www.huduser.gov/portal/datasets/lihtc.html (last revised May 24, 2019).

3. Joint Ctr. for Hous. Studies of Harvard Univ., America's Rental Housing: Evolving Markets and Needs 8 (2013), https://www.jchs.harvard.edu/sites/default/files/jchs_americas_rental_housing_2013.pdf.

4. *The Low-Income Housing Tax Credit Program at Year 25: An* Expanded *Look at Its Performance*, CohnReznick LLP (2012), https://cohnreznick-sitecore-prod-cm.azurewebsites.net/~/media/resources/cohnreznick-lihtc-2012-fullreport.pdf.

5. See Epilogue for potential changes from pending legislation.

6. Novogradac Low-Income Housing Tax Credit Handbook (most recent edition 2019).