THE CRA and LIHTCs

I. Overview

A. Low Income Housing Tax Credits (LIHTC)

LIHTC provides a tax incentive to construct or rehabilitate affordable rental housing for low-income households. The LIHTC was enacted as part of the 1986 Tax Reform Act.\(^1\) Between 1987 and 2016, LIHTC has subsidized the acquisition, construction, and rehabilitation of 46,554 projects and 3.05 million housing units.\(^2\) Beginning in 1995 reforms to the LIHTC program incentivized financial institutions to invest in affordable rental housing for low- and moderate-income tenant.

B. How the Low Income Housing Tax Credit Works

1. Allocation

The federal government issues LIHTC to state and territorial governments. Using a competitive process, state housing agencies award the credits to private developers of affordable rental housing projects. Developers the sell the LIHTC to private investors to obtain funding. Investors can claim the LIHTC over a 10-year period after the housing is tenant-ready.

2. Eligibility

Rental housing, including apartment buildings, single-family dwellings, townhouses, and duplexes are LIHTC eligible. The statute requires that developers use an income test for tenants and a gross rent test to determine eligibility.\(^3\) The gross rent test requires that rents do not exceed 30 percent of either 50 or 60 percent of AMI, depending upon the share of tax credit rental units in the project. All LIHTC projects must comply with the income and rent tests for 15 years or credits are

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\(^1\) P.L. 99-514.
\(^2\) LOW-INCOME HOUSING TAX CREDITS Dataset, 6/6/18. https://www.huduser.gov/portal/datasets/lihtc.html, revised
\(^3\) There are three ways to meet the eligibility requirements.
   1. At least 20 percent of the project’s units are occupied by tenants with an income of 50 percent or less of area median income adjusted for family size (AMI).
   2. At least 40 percent of the units are occupied by tenants with an income of 60 percent or less of AMI.
   3. At least 40 percent of the units are occupied by tenants with income averaging no more than 60 percent of AMI, and no units are occupied by tenants with income greater than 80 percent of AMI.
recaptured. In addition, an extended compliance period (30 years in total) is generally imposed.4

3. Participants

LIHTC deals are complex. Investments are made directly or indirectly through a syndicator, who acts as an intermediary to locate LIHTC transactions for investors. Financial institutions make LIHTC decisions based on their CRA assessment area(s). In addition to private investors, developers, federal and state governments, real estate specialists, tax and legal experts are also involved.

II. Using the LIHTC to Meet CRA Requirements

A. The Community Reinvestment Act (CRA)

The CRA is a federal banking statute initially enacted to reverse decades of disinvestment urban areas. The federal statute requires federally-insured financial institutions to meet the credit needs of the communities in which they operate, including low- and moderate-income (LMI) neighborhoods. The institutions are evaluated on an annual basis to determine if they both accepting monetary deposits in distressed neighborhoods and are also meeting the investment and borrowing needs of those neighborhoods.5 Since 1996, banks have made approximately 551,000 community development loans worth $796 billion.6

B. CRA Requirements

The CRA evaluates bank performance in three areas: lending, investments, and service.7 A LIHTC project qualifies for CRA credit under the investment test.8 LIHTC provides banks with a safe and sound investment in affordable housing. Banks may choose to participate in LIHTC projects as investors, using LIHTCs to provide equity in exchange for the tax credits, or as lenders, providing the projects with either short-

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4 § 42(h)(6)(A)–(B), (D).
5 12 U.S.C. 2901-2908,
8 See, The 2001 Interagency CRA Questions and Answers, 12(s) 563e.12(r)-4; the 2001 Interagency CRA Questions and Answers, 23(a)-1 and 12(s) 563e.12(r)-4.
term or long-term financing. To earn credit, banks must use LIHTCs in the communities they service.\(^9\) Banks that have been responsive to community development needs and opportunities in its geographic assessment areas. A bank may also earn CRA credit for activities outside of its AA(s).

B. CRA Issues

Where banks will receive the most CRA credit often drives the placement of LHTC projects. This is tied to syndication because profitability is a significant factor in project development. Syndicators purchase the tax credits for sale to investors from developers at a discount. The syndication, which maintains a minimal ownership stake, is responsible for ensuring the property generates enough cash flow for ongoing debt repayment and remains in compliance with income and rent restrictions. A LIHTC syndication earns upfront fees but lower ongoing asset management fees on the projects they syndicate.

Often the state housing agency limits the amount of the syndicator’s fee given the total costs of the project. This ensures that the property’s equity is not improperly absorbed by fees. Having diverse investors may affect the quality of the underwriting, which ideally is solved by more transparency in the underwriting process.

III. The Future of the CRA and LIHTC

LIHTC produces and preserves affordable housing by relying on bank investments and the incentives that CRA provides. Approximately 85 percent of the annual low income housing tax credit (LIHTC) equity investment is CRA-driven.\(^{10}\) Recent changes to the federal tax system and proposed changes to the CRA could affect the availability of affordable housing and banking industry and the low- and moderate-income (LMI) communities they serve.

\(^9\) See, The 2001 Interagency CRA Questions and Answers, .12(i) & 563e.12(h)-5 and the 2007 proposed Interagency CRA Question and Answers, .23(a) – 2 that addresses the geographic requirements for qualified funds.

\(^{10}\) Cohen Reznick, What Do Higher LIHTC Prices Mean for Syndicators?, AFFORDABLE HOUSING NEWS & VIEWS (Spring 2014).
A. Legislative Changes Affecting LIHTC

The 2017 revision to the Internal Revenue Code reduced corporate taxes and placed limits on the deduction of net operating losses. Over time, this could reduce the demand for LIHTCs.

Under the 2018 Consolidated Appropriations Act the amount of credits available to states increased by 12.5% from 2018-2021. The income test now allows for income averaging across tenants, making this eligibility factor easier to meet.

C. Proposed Regulatory Changes to the CRA

In September 2018 the Office of the Comptroller of the Currency (OCC) released a notice of proposed rulemaking (NPR) soliciting public comment on reform of Community Reinvestment Act (CRA) regulations. Changes in the CRA incentives, defining assessment areas and/or qualifying projects could affect community development financing of LMI communities in general and how financial institutions meet their CRA requirements.

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11 P.L. 115-97.
12 P.L. 115-141.