What is the risk that LIHTC Properties in Massachusetts will convert to Market?

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Executive Summary

Beginning in 1990, affordable rental housing funded under the Low Income Housing Tax Credit (LIHTC) program has been required to have a minimum term of a 30 year affordability restriction. Policymakers and researchers including the New England Public Policy Center have widely assumed that most of these housing projects will lose affordability 30 years after they were ‘placed in service’ with a potential risk of over 15,000 units in Massachusetts by 2030. However, CEDAC has conducted an in depth look at the affordability restrictions of the 228 LIHTC projects that were placed in service from 1990 through 2000 and the results show that this assumption is not correct. Roughly 86% of the 15,679 LIHTC units in this cohort are subject to some form of longer term affordability restriction and will not be at risk for market conversion before December 31, 2030. This is extremely good news since it means that at least 13,466 of these LIHTC units will continue to be a resource for low income families and individuals until sometime after 2030. Although most projects have no risk of loss of affordability through conversion to market rate in the near future, the housing is approaching 30 years of age and will need funding for recapitalization. Therefore, it will be necessary for public agencies to continue capital investment in this housing stock.

I. Introduction

The Low Income Housing Tax Credit ‘Year 30’ issue that begins in 2020 is far from the first preservation challenge that Massachusetts has faced. As early as the 1970’s the state grappled with a large number of defaults in affordable housing projects; in the 1980’s with mortgage prepayment; and at the beginning of the millennium with HUD mortgage maturities. Massachusetts is currently in the last stages of one of its biggest ever preservation challenges, the mortgage maturities from 2017 to 2020 of roughly 4,000 affordable units in 30 at-risk multifamily housing projects financed under the Section 13A program. Preserving the 13A portfolio has required tremendous efforts from several public agencies, particularly MassHousing and the City of Boston. But just as one preservation challenge ends, another begins. Starting in 2020 Massachusetts will confront the next wave of projects facing the risk of loss of affordability – those reaching the end of the 30 year affordability period under the Low Income Housing Tax Credit (LIHTC) program. By the end of 2030, 228 projects with 15,679 affordable units will reach Year 30, indicating that the LIHTC preservation problem is potentially much bigger in scope than the 13A. In order to respond to this upcoming challenge, it is critical that state policymakers quantify the magnitude of the problem and develop a plan to respond to projects reaching Year 30. To begin to
understand and address the issue, this paper provides the initial results of research on affordability terms for all of the projects reaching Year 30 through the end of 2030.

II. Description of LIHTC Program

LIHTC is a federal tax credit that is one of a number of tax expenditures that uses the tax code instead of direct government appropriations to carry out a governmental funding activity, in this case the funding of affordable rental housing developments. LIHTC is administered by each state through a governing document called the Qualified Allocation Plan (QAP), which sets state priorities for LIHTC funding. Developers of affordable housing apply for funding to their state agency in a competitive process, committing to provide a certain number of affordable housing units, which are typically limited to individuals and families earning no more than 60% of the Area Median Income (AMI) for the project location. LIHTC is designed so that the tax credit may be claimed by corporate investors who provide equity to the project in exchange for 10 years of tax credits that offset federal corporate income tax liabilities. The program is structured so that if rent levels or resident income requirements are not met, then the IRS can recapture tax credits for up to 15 years after a project is placed in service. For a new construction project, the placed in service date typically occurs when completed units are first occupied, though when renovating occupied housing the placed in service date may be prior to the completion of construction.

Since the program was first rolled out in 1987, it has proven to be extremely versatile, funding a wide array of rental housing. While a typical project may involve new construction of 30 or more rental apartments for low income families and individuals, LIHTC is able to fund housing for special populations including elderly, veterans, formerly homeless residents, etc. LIHTC can be used in building types ranging from duplexes to high rises and often involves the renovation of existing affordable housing, the adaptive reuse of mill buildings and schools into housing, and the historic preservation of older residential structures.

Due to LIHTC’s flexibility, it is possible to layer various forms of operating subsidy such as Section 8 with LIHTC so that while the maximum tenant income is normally 60% of (AMI), LIHTC projects can serve a mixed-income tenant base that includes residents with Extremely Low Incomes (ELI) between 0 and 30% of the AMI. According to HUD data, in Massachusetts, 63% of the residents of LIHTC projects have are ELI households. Consequently, LIHTC properties represent a critically important resource for ELI renters in Massachusetts that could be in jeopardy if many LIHTC projects convert to market rate at Year 30.

Since its inception roughly 33 years ago, LIHTC has become the largest affordable housing production program in the country, and funds the production or preservation of approximately 107,000 affordable housing units each year. As of 2017, there were 3.1 million LIHTC units nationwide. In Massachusetts, the program has funded over 60,000 affordable units through 2017 and is currently funding approximately 3,300 LIHTC units statewide each year.
III. Approaching Year 30

In order to understand the risk of loss as LIHTC projects reach Year 30, it is necessary to look at the early history of the tax credit program. LIHTC was created as part of the Tax Reform Act of 1986 as a three-year program with the initial projects funded in 1987. During these first three years, the minimum affordability term was 15 years from the date that a project was placed in service. In 1989, Congress passed tax legislation that increased the minimum affordability term to 30 years for LIHTC projects funded in 1990 or after. Consequently, although the LIHTC program is over 32 years old, no project has arrived at the Year 30 maturity date, since the first projects with longer term restrictions were funded in 1990 and will not reach Year 30 until sometime in 2020. Congress has not made any substantive changes in the affordability requirements since 1990, so all projects funded after 1989 have affordability terms of at least 30 years.

While developers of LIHTC projects must commit to a minimum affordability term of 30 years, states are able to incentivize longer affordability terms by awarding additional points in the competitive application process. However, there is very little data on how many projects have committed to longer term affordability, so researchers have tended to assume that almost all projects have the minimum 30 year term.\textsuperscript{vi}

One of the concerns regarding Year 30 is that the preservation of housing originally financed in the 1990’s may require a significant portion of a state’s affordable housing funding resources in the 2020’s. A glance at the production data shows the magnitude of the potential problem. From 1990-2000, LIHTC funded a total of 15,679 units in Massachusetts, which averages 1,425 units per year. This is a significant fraction of the roughly 3,300 LIHTC units that the state currently produces each year\textsuperscript{vii}. However, as the following section will show, the number of projects and units at risk for loss of affordability is in fact much smaller than these global numbers would suggest.

IV. LIHTC Data

Although LIHTC is now the largest and most important federal affordable housing program, funding approximately 3,300 units per year statewide, LIHTC in the beginning years had a much smaller impact. Beginning with projects funded in 1990, the 30 year affordability requirement took effect. In that year, just 318 units were both funded and placed in service. The number of units placed in service grew slowly to 330 units in 1991 and 462 units in 1992. The program gained momentum over the next several years and by the year 2000, output had increased to 2,860 LIHTC units placed in service. Fast forward to the early 2020’s, the number of LIHTC units that will reach Year 30 likewise starts out very small but accelerates towards the end of the decade.
Knowing the number of units that were placed in service each year in the 1990’s is only the first step in understanding the preservation challenge. The real question is the number of units that are at risk each year starting in 2020. A careful look at affordability restrictions shows that the vast majority of LIHTC projects have affordability restrictions that will extend beyond 2030. There are multiple reasons for longer affordability periods, including long-term LIHTC restrictions, a refinance of the LIHTC project extending the term of affordability requirements, and 20 year Section 8 contracts. One of the most common reasons for longer affordability is a Tax Credit Regulatory Agreement (TCRA) that extends for 50 or 99 years, well in excess of the 30-year minimum term. Longer term TCRA’s reflect commitments that developers agreed to at the time of the project’s initial funding application to the state in order to score more points in the competitive process. This small change, which arguably cost the state nothing at all, is responsible for preventing 58 projects with 3,000 units from being at risk in the next decade.
A second cause of affordability beyond 2030 is some form of refinance, typically in the past 10 years. A resyndication with LIHTC or refinancing using other public funds always requires new affordability restrictions typically adding 15-45 years of additional affordability. To date, roughly 3,300 units of housing have restrictions that have been extended beyond 2030 in this way. A third category consists of projects with long-term Section 8 contracts. These contracts are generally for a term of 20 years, and projects with over 2,100 units have Section 8 expirations after 2030. Since Section 8 contracts are binding agreements between the owner and the government, they can serve to ensure continued affordability, even in the absence of other restrictions. Finally, projects with over 4,000 LIHTC units took advantage of other capital funding programs that required affordability for longer than 30 years. Examples of these programs in the 1990’s include the state’s Housing Innovations Fund, certain municipal funding sources, and developments funded through the federal Rural Development Section 515 program. viii It should be noted that a number of projects have multiple long-term restrictions, for example a 50 year TCRA and a long term Section 8 contract. CEDAC’s analysis does not attempt to identify every overlapping restriction for projects that are not at risk prior to 2030. Instead the totals above only identify a single factor resulting in long-term affordability for each project.

The net effect of all of these different types of restrictions is striking. From 1990 through 2010, there were 15,679 LIHTC units funded in Massachusetts. Of this total, only 47 projects with 2,213 units (14% of the total) will be at risk before the end of 2030. These 47 projects are disbursed throughout the state, though clustered near Boston and Worcester. The remaining projects with 13,466 units have some form of legal requirement to maintain affordability beyond 2030 – ranging from expirations in 2031 to projects that have agreed to affordability in perpetuity. ix
Finally, the actual risk of displacement for tenants residing in the 2,213 at-risk units is somewhat less than it would appear thanks to the state’s housing preservation statute, Chapter 40T. Section 7 of the law provides that for three years after a termination, owners can only increase rents charged to low-income residents by 3% plus the consumer price index per year. Practically speaking, most LIHTC residents will be able to continue to stay in their units for at least three years after the owner begins a market conversion. However, since these allowable 40T rent increases present some risk of economic displacement, the at-risk totals in this paper have not been adjusted for the three years of 40T tenant protections.

V. Conclusion

The New England Public Policy Center and other researchers have voiced the concern that preserving the at-risk LIHTC projects will divert a sizable percentage of the state’s affordable housing resources over the next decade; however, the Year 30 challenge appears much more manageable. The 2,213 units at risk over the next 11 years represents just 14% of all of the units reaching Year 30.
percentage will continue to decline slowly over the next few years as additional LIHTC owners refinance their projects or extend maturing Section 8 contracts.

One of the most important results from this analysis is that the risk for ELI residents is also much less than anticipated. Using estimates on the percentage of ELI residents in early LIHTC projects, about 9,900 ELI households presently inhabit the 15,679 projects that will reach Year 30 from 2020-2030, with about 1,400 ELI households living in units at risk. Even with some form of operating subsidy, these tenants may have significant difficulty finding alternate housing if they are displaced through a market conversion of their property. Further information is therefore needed on the numbers of ELI residents living in at-risk projects.

Although most projects in this cohort cannot convert to market before 2030, funding will still be needed for capital repairs. Virtually all residential properties, whether market rate or affordable, need to be recapitalized every 20-30 years. While market rate projects can generally support refinancing with new performing debt, affordable properties with their restricted cash flow often need additional public subsidy. These recapitalization transactions rarely require the use of the scarcest public resources and can generally wait a year or two for funding to become available if necessary. Indeed this process is already occurring. In 2018, for example, state agencies provided some form of subsidy funding for the recapitalization of over 800 affordable units, including LIHTC units, that were not at imminent risk of loss of affordability.

Policymakers have increasingly understood the importance of affordability restrictions longer than 30 years. At the state level, the Capital Improvement and Preservation Fund requires a 40-year affordability term, the state housing tax credit program requires 45 years, and the Housing Stabilization Fund requires 50 years of affordability. The City of Boston and a few other localities have gone still further, requiring affordability in perpetuity as a condition for receiving almost all forms of funding commitments.

With 32 years and 3 million affordable units under its belt, the federal LIHTC program is generally seen as one of the most successful housing production programs ever. Outcomes in Massachusetts have been no less impressive, with over 60,000 units of housing and a negligible foreclosure rate. This paper lays to rest a concern that most of the units produced in the 1990’s will be lost as affordable housing in the 2020’s. In fact, 86% of the LIHTC units produced from 1990 through 2020 have affordability restrictions that extend past 2030. The state’s preservation goals should now be to continue to preserve high priority at-risk units while also assisting owners of projects with longer affordability restrictions to recapitalize their properties so these projects continue to serve as quality housing for decades to come.

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**Footnotes:**

1. Including projects that reach Year 30 from 2020 through the end of 2030 of course covers a period of 11 years, but as will be described below, only 3 projects were placed in service in 1990 while 34 properties were placed in service in 2010. Decennial thinkers can reasonably think of the Year 30 problem as beginning in 2021.

2. The LIHTC program is extremely complex and this paper contains only a very cursory overview, omitting mention of many exceptions and special conditions. Several good primers exist such as the introduction by Westmont Advisors entitled, “Understanding the LIHTC,” Westmont Advisors, accessed September 23, 2019. [https://westmontadvisors.com/tax-credit-advisory/introducing-the-low-income-housing-tax-credit-lihtc/](https://westmontadvisors.com/tax-credit-advisory/introducing-the-low-income-housing-tax-credit-lihtc/)

https://www.huduser.gov/portal/datasets/lihtc.html

Current production in Massachusetts represents the author’s average of all types of LIHTC funding statewide averaged using 2016 through 2018.  

https://www.lincolninst.edu/sites/default/files/pubfiles/reina_wp18vr1.pdf

LIHTC allocations to the states have increased over the years which explains some of the increase in current funding levels over those in the 1990’s.

To add to the complication, several of these funding programs have different affordability terms depending on the time period. For example, the Housing Innovations Fund in the early 1990’s had 40 year restrictions, but this was shortened by statute to 30 years in the mid 1990’s. Meanwhile the Housing Stabilization Fund initially required 30 years of affordability, though the statute was later changed to require 50 years for projects funded after 2002.

Most Massachusetts ‘perpetuity’ LIHTC restrictions in the 1990’s were in fact 99 year affordability requirements. However, other agencies have required truly perpetual restrictions – ones that have no end date.

Data is not available on the percentage of ELI residents residing specifically in the cohort of projects placed in service from 1990-2000. Assuming the overall percentage of 63% ELI is similar for this cohort of projects, means that for the 2,213 at risk units, approximately 1,394 residents are ELI households.

Author’s tally of state preservation funding in 2018, excluding projects at high risk and projects that were recapitalized exclusively with new performing debt from MassHousing or Mass Housing Partnership.

The Massachusetts state housing tax credit is independent of federal LIHTC but operates similarly with investors providing equity in exchange for credits against state tax obligations