

The 4% Housing Tax Credit Fix of 2020

Intro

On December 27, 2020 the federal government enacted an omnibus budget bill that included a provision affordable housing advocates have been seeking for a number of years – the 4% housing tax credit fix. Though a fairly obscure provision, this ‘4% fix’ is extremely good news for housing development in our state as it will increase the funding from the 4% housing tax credit program by roughly 29% annually.

LIHTC Basics

The Low Income Housing Tax Credit (LIHTC) is a crucial source of funding for the production of affordable rental housingⁱ as well as the preservation/renovation of existing affordable housing. 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 132,000 affordable housing units each year.ⁱⁱ As of 2019, there were 3.4 million LIHTC-assisted units throughout the country,ⁱⁱⁱ and it has been estimated that LIHTC is involved in 90% of the affordable housing produced nationwide each year.^{iv} In Massachusetts, LIHTC has funded almost 63,000 affordable units through 2019.^v

The LIHTC program was created as part of the 1986 Tax Reform Act to subsidize the acquisition, construction and renovation of affordable rental housing. LIHTC is designed as a tax credit that may be claimed by corporate investors who provide cash equity to a housing project in exchange for 10 years of tax credits that offset federal income tax liabilities. The tax credit is available in two different forms called the 9% and 4% credits. The larger 9% credit is allocated through periodic funding rounds. In Massachusetts, the Department of Housing and Community Development (DHCD) has a highly competitive annual funding round for 9% LIHTC applicants and each year roughly 100 projects apply for approximately 30 awards.

A second type of LIHTC, the 4% credit, is available for rental projects financed by private activity tax-exempt bonds. In general, the 4% credit provides less than half the funding per apartment as the 9% credit and is therefore much less useful for new construction projects. In contrast to 9% LIHTC applications, developers seeking bonds and 4% credits apply to either MassHousing or MassDevelopment on a rolling basis^{vi}. Though the two agencies have significant application requirements, the process is less competitive than for 9% tax credits.

The amount of credits that each 9% or 4% LIHTC project is eligible to receive is based on a fairly complicated formula. The 1986 legislation specified that the IRS should allow two percentages to float

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based on applicable federal rates to maintain the present value of the 10-year tax credit stream for both 9% and 4% credits. Thus, the common names for the two forms of LIHTC were loosely based on interest rates early in the program. However, since the LIHTC rates float with current interest rates, the actual 9% and 4% credit rates have rarely been exactly at their stated amounts. In 2008, as part of a recession era funding bill, the credit rate for the 9% tax credit was temporarily fixed at exactly 9%, and this provision was later made permanent in 2015. Until 2020, the 4% credit rate had continued to float. In 2020, interest rates were significantly below those in 1986 and so the actual rates for 4% tax credits had been floating much closer to 3% than to 4%. The rate dipped as low as 3.07% in August 2020 and ended 2020 at 3.09%. Beginning in 2021, tax exempt rental housing projects receive a fixed 4% credit rate.^{vii}

4% Credit in Massachusetts

Each state is allowed to issue a certain amount of tax-exempt private activity bonds (“volume cap”) each year. In 2021, most states receive \$110 per capita, and Massachusetts will receive slightly over \$750 million for its volume cap allocation for 2021. In recent years, about 70% of state volume cap has been dedicated to multifamily rental housing to generate 4% LIHTC,^{viii} and in 2018 Massachusetts ranked 8th in the country for the dollar amount of volume cap that went to rental housing for 4% LIHTC projects.^{ix} In 2019, Massachusetts provided 4% credits to 17 production and preservation projects with 1,800 affordable units.^x

Fixed vs Floating

The difference between a fixed and a floating rate 4% credit is fairly dramatic. All other things being equal, a project that issued bonds in January 2021 (receiving a fixed 4% rate) instead of December 2020 (with a floating rate of 3.09%) would have received 29% more LIHTC equity ($4.0\% \div 3.09\% = 1.29$). For one 4% project, the calculated increase was 30%.^{xi} Urban Edge, a Boston nonprofit community development corporation, is refinancing a 78-unit existing affordable housing project called Bancroft Dixwell with 4% credits. The 30% increase in equity translated to over \$4 million in additional funds for the renovation of the project. An overall statewide annual increase in equity generated from the sale of LIHTC funding resulting from the 4% fix is roughly \$150 million.^{xii}

This extra funding will provide a number of potential benefits. In many housing preservation deals, it will allow renovations that previously did not fit in the budget to be included. In some projects, the increased equity from 4% LIHTC will allow other sources of governmental funds to decrease. An additional benefit is that some new construction projects will pencil out with 4% credits for the first

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time. Prior to the 4% fix, very few new construction projects were possible using 4% credits, even when other governmental funding was provided.

While the increased value of the credit is the main goal of the 4% fix, there is also the benefit in knowing well before the closing what the tax credit rate will actually be. Until now, developers have had to estimate what the credit rate would be until the time that they were able to lock the rate near the beginning of construction. Consequently, developers needed to include a cushion in their numbers since they could not be sure what the final 4% rate would actually be.

Conclusion

The 4% fix is tremendously beneficial to Massachusetts as it provides approximately \$150 million annually in additional tax credit equity for 4% LIHTC projects which will benefit the production as well as the preservation of affordable housing in the state. Coupled with other recent state action on housing funding, such as the increase in the state housing tax credit, the 4% fix will materially increase the number of affordable rental housing projects that can be funded each year.

ⁱ Affordable housing in this context is rental housing that is targeted to individuals and families who generally earn 60% or less of the Area Median Income.

ⁱⁱ Novogradac and Co. April 2021,

https://www.novoco.com/sites/default/files/thumbnails/image/lihtc_mf_vs_lihtc_starts_chart_2021v2-01.png

ⁱⁱⁱ Action Campaign, 2021, <http://rentalhousingaction.org/state-district/#Massachusetts>

^{iv} Moore, Kimberly C., "Congress Establishes the 4% Floor to Support Affordable Housing", Pillsbury Grave2Gravel Construction and Real Estate Law Blog, <https://www.gravel2gavel.com/congress-four-percent-floor-affordable-housing/>

^v Action Campaign, 2021, <http://rentalhousingaction.org/state-district/#Massachusetts>

^{vi} For more information on LIHTC and 4% issues, see Brauner, Bill, "Preserving Affordable Housing in Massachusetts with Private Activity Bonds and 4% Credits." July 2015. <https://cedac.org/wp-content/uploads/2016/06/PAB-White-Paper-Aug-13.pdf>

^{vii} As may have been surmised, the '4% fix' does not refer to the repair of something broken, but rather the rate will no longer float and is now fixed or locked at exactly 4% going forward.

^{viii} Student loans have been the second largest use of volume cap with relatively small amounts of volume cap used for first time homebuyer loans and industrial development loans.

^{ix} Council of Development Finance Agencies, "CDFA Annual Volume Cap Report" October 2019

<https://www.cdfa.net/r/VolumeCapReport2018.html> As of July 2021 the 2019 report, which would normally be released in the fall of 2020, was not yet available.

^x Author's tally of data from MassHousing and MassDevelopment

^{xi} Urban Edge provided a calculation between its initial projections using the July 2020 credit rate of 3.08% and the 2021 fixed rate of 4.0%.

^{xii} \$750 million in total volume cap x 70% for rental housing x 29% increase from the 4% fix. This is a fairly rough estimate and will change each year based on the amount of volume cap that is allocated to affordable rental housing.