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Who Benefits from Federal Housing Tax Credit Changes?

On Dec, 21, 2020, Congress passed the Consolidated Appropriations Act, a year-end measure that includes a $1.4 trillion omnibus spending bill and a $900 billion Covid-19 relief bill.

Among many other things, the act fixed the 4% low-income housing tax credit (LIHTC) applicable percentage at a minimum of 4%. This comes after years of advocacy by LIHTC stakeholders and is expected to generate millions more in equity investments for affordable housing and lead to the production and preservation of tens of thousands more affordable units, with some estimating that an additional 126,000 affordable rental homes will be created or preserved over the next decade as a result of 4% fixed rate.

Before the act, the rate had always floated and was tied to the federal borrowing rate. During the 2020 fiscal year, the rate dropped as low as 3.07% as a result of cuts to the federal borrowing rate in response to the pandemic.

Fixing the LIHTC rate to 4% has positive implications for the growth of the affordable housing market. Given that historically the floating rate was lower than 4%, the higher fixed rate creates an added incentive for equity investors to invest in LIHTC projects.

But what does this mean for developers and existing projects that have secured LIHTC bond funding in 2020, but have drawdowns carrying over to 2021? Will those projects benefit from this new rate floor?

According to the act, whether a project will benefit from the new fixed 4% rate is based on several factors:

- For bond-financed projects that rely on 2021 bonds and are entirely placed in service after Dec. 31, 2020, the 4% fixed rate will apply.
- For non-bond-financed projects, the 4% fixed rate applies to acquisitions of used buildings provided the credits were allocated after Dec. 31, 2020.

It is unclear how the IRS will handle projects with undisbursed 2020 bond proceeds and whether those projects can quality for the 4% fixed rate.

Further guidance from the IRS and Congress will be needed on this issue in the form of a statement from the IRS or a “Blue Book” report from the Joint Committee on Taxation. However, this could take some time — “Blue Book” reports, for example, have taken between nine months and two years to be issued in the past. So, what should project sponsors and developers do in the interim?

The answer to how treat tax-exempt bonds that were allocated in 2020 with undisbursed proceeds in 2021 may come down to the how the IRS chooses to define “issuance.”

In the past, the IRS has defined “issuance” to mean when the proceeds were drawn down. This definition was designed in part to foil the efforts of projects that rushed to secure bond financing ahead of enactment of impending laws that would have unfavorable effects on tax-exempt bonds.

If the IRS retains this definition of “issuance,” bonds issued at a floating rate below 4% in 2020 that carried undrawn funds into 2021 could be considered “issued” in 2021 and would technically be considered eligible for the 4% fixed rate. But it’s hard to say whether the IRS will take the same position it did in light of the more favorable effects of the current act.

If, instead, it were to ascribe the traditional meaning to the word “issuance,” then the fixed rate would only apply to bonds that are literally sold in 2021. Alternatively, the IRS could take a hybrid approach to defining “issuance,” allowing for a 4% fixed rate to apply to bonds that were issued in 2020 but were drawn down exclusively in 2021.

Given the uncertainty of the IRS’s approach, Sheehan Phinney is not issuing any opinions on whether 2020 bonds qualify for the 4% floor rate without further guidance from the IRS or Congress.

Another consideration is found in Section 42(m)(2)(d) of the Internal Revenue Code, which requires that the governmental unit issuing the bonds make a determination that the project financed with tax-exempt bonds meets the requirements of the state’s Qualified Allocation Plan, and that only the amount of tax credits needed for project feasibility will be applied to the project.

Essentially, the state agency issuing the bonds needs to find that the project needs the credits. So, what would happen if the parties to a project had closed a deal at a 2020 floating rate and then went back to the state to request a 4% rate?

Theoretically, the parties would need to re-evaluate the sources of financing and the state agency would need to revise its assessment of how much credit authority is needed.

The best solution seems to be that the project sponsor must take a position to either ask the state agency to reevaluate the project at a 4% fixed rate and leave it up to the state agency or to stick with the floating rate it was awarded previously.

Peter Beach and Jaclyn Fisher | February 19, 2021