4% LIHTC Fix Helps Affordable Housing Industry

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The affordable housing industry has used 4% Low-Income Housing Tax Credits ("4% Credits") to finance affordable housing since the program's inception in 1986. Investors contribute capital to special purpose entities that own affordable housing in exchange for an allocation of the 4% Credits. This capital is then used in the overall capital stack for the construction or rehabilitation of the affordable housing development.

4% Credits are frequently used because, unlike 9% Low-Income Housing Tax Credits, 4% Credits are not awarded on a competitive application process, rather, any affordable housing project awarded volume cap and financed with tax-exempt bonds in accordance with the Internal Revenue Code of 1986, as amended (the "Code"), may qualify for the 4% Credits. Although 4% Credits are an important part of the capital stack of affordable housing developments, their use created financing uncertainty because their value tied to Treasury Department interest rates, and in recent years the actual value of 4% Credits fluctuated between 3.07% to 3.32%. Because of these historical lows and monthly fluctuations, transactions dependent on the value of 4% Credits faced financing gaps and development challenges.

The Consolidated Appropriations Act, 2021, fixed a permanent floor for 4% Credits at 4% for affordable housing projects that are (1) placed in service after December 31, 2020, and (2) financed with tax-exempt obligations issued after December 31, 2020 in accordance with the Code. This minimum rate may make more projects financially feasible and significantly increase the available supply of affordable housing units for several reasons. First, the minimum 4% rate should simplify project budgeting processes and investors and developers will not have to estimate the value of their 4% Credits throughout the financing process. This will permit them to eliminate or minimize previous requirements for additional sources in the capital stack and have more certainty during the underwriting process. Second, the total amount of investor equity

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funding in projects could increase since 4% Credits are now worth a minimum of 4% instead of less than 3.32% in recent times. This increased equity may be used to increase the number of constructed or rehabilitated units, add amenities to the development, reduce reliance on taxable or subordinate debt or defer less of the developer's fees and costs.

While fixing the value of 4% Credits at a minimum of 4% may simplify transactions in the long-term, in the short-term complexity is added. Developers and their financing teams may need to restructure transactions that have already been approved by State Housing Agencies or other issuers of tax-exempt bonds because of the credit floor added to the 4% Credits. Developers and investors may want to revisit draft Operating Agreements and financial models to determine what additional 4% Credits and/or equity may be available to the project due to the 4% floor. Second, developers will need to rework their sources and uses for their projects if the projects now have the potential to generate more 4% Credits, and thus more equity. Developers may wish to use less taxable or subordinate debt or defer less of their fee, or developers may increase the number of units or add amenities. Finally, developers should keep in close contact with State Housing Agencies or any other governmental entities which are issuing tax-exempt or subordinate debt for the affordable housing development. These issuers and lenders may need to reapprove the project if the capital stack or development have changed beyond the parameters originally used to award volume cap, credits or other grants or resources under the state's qualified action plan or other funding programs. Because many issuers do not yet have policies in place to address these changes caused by the credit floor in value of the 4% Credit, developers should reach out to bond counsel or issuers so that closings are not delayed.

At the time of publication of this client alert, the Internal Revenue Service has also extended certain temporary relief offered to developers of affordable housing until September 30, 2021 that had expired on December 31, 2020. Contact a member of Frost Brown Todd's Public Finance or Multifamily Housing industry teams for more information regarding this temporary relief.

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For more information about the 4% fix or using tax-exempt bonds for affordable housing development, please contact the authors or any attorney with Frost Brown Todd's Public Finance or Multifamily Housing industry teams.

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