Affordable Housing and the Build Back Better Act

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While the affordable housing industry started 2021 with a big win when the 4% low-income housing tax credit (the "4% LIHTC") was fixed at a true 4% rate, it has the potential to end the year with several additional big wins that will change the industry for at least the next five years.

How much momentum the affordable housing industry has going into 2022 depends on whether the Build Back Better Act (the "Act") (technically the Reconciliation Bill) is enacted into law and what affordable housing provisions make it. Here is where the affordable housing market stands as of this writing and how developers and owners of affordable housing projects can best position themselves for the next several years based on what we know right now.

Current Status of Build Back Better Act

The affordable housing industry must address two primary demands: first, the demand for additional affordable housing, especially in high-cost urban areas and second, the demand of residents and the community-at-large for newer amenities and environmentally safer living spaces.

Currently, Title XIII, Subtitle E, Part 1 of the Act modifies the 4% LIHTC rules to permit additional construction/rehabilitation of affordable housing that will most likely benefit states with higher-cost urban areas. Additionally, Title IV, Subtitles A and B of the Act, distributes federal funds via the Department of Housing and Urban Development (HUD) to state and local housing agencies which can use these funds to improve publicly owned affordable housing and to award grants to for-profit and non-profit owners to modernize their affordable housing properties.
While both provisions of the Act have legislative support, based upon the legislative history of the Act, it seems likely that providing

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federal funds to state and local housing agencies will remain in the Act while modifying the 4% LIHTC rules may not.

Multiple expansions of the 4% LIHTC program were included in the first version of the Act released on Sept. 27, 2021; then all expansions of the 4% LIHTC program was removed from the version of the Act based upon the White House's Build Back Better framework released on Oct. 28, 2021. Further, on Nov. 3, 2021, a limited expansion of the 4% LIHTC program was reinserted in the version of the Act currently being considered by the House of Representatives.

These 4% LIHTC provisions may be removed from the final Act because moderate Democrats in the House have indicated that they may not support the Act should the Congressional Budget Office (CBO) score the current Act's costs higher than those projected by the White House in its Build Back Better framework. Since the White House's framework did not include any 4% LIHTC provisions the CBO's score may be higher and these provisions may have to be stripped to make the cost projections more similar.

Federal Funding of State and Local Housing Agencies

Congress provides significant funding to HUD to create additional affordable housing and to improve existing affordable housing units in Title IV of the Act. HUD will allocate a portion of these dollars to state and local housing agencies which will use some of these funds to improve publicly owned units; however, some funds are earmarked for loans and grants to for-profit and non-profit owners of affordable housing. These private owners should be prepared to reach out to state and local housing agencies about these programs once the Act has been enacted.

The Act sets aside $740 million to fund grants to non-profits that wish to develop, preserve or rehabilitate housing for low-, very-low and extremely low-income families. Non-profits may also use these grants to develop community facilities related to these units. The Act dedicates $1.2 billion to funding Section 24 grants to non-profit and for-profit owners of affordable housing to improve the health

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and safety, energy efficiency, and climate and disaster resilience of affordable housing units, and another $1.770 billion to improving the energy efficiency of units and installing zero emissions electrical generation and storage equipment and electric car charging stations.

The Act also dedicates $1.55 billion to making loans and grants to owners of projects at risk of becoming physically obsolescent or economically non-viable that wish to improve these projects but current rents make such improvements economically infeasible.

Many of these programs expire by or prior to fiscal year 2029, so non-profit and for-profit owners should be ready to reach out and take advantage. Many of the programs are competitive so being first in line would be a good idea.

4% LIHTC Provisions

The 4% fix effectively increased the 4% LIHTC rate by 91 basis points on Jan. 1, 2021, (from 3.09% to 4.00%). This increase, along with the certainty of the value of the 4% LIHTC for each project, resulted in an additional infusion of private investor capital into the affordable housing sector which made additional projects financially feasible.

This positive impact may have been limited in California, Colorado, Florida, Georgia, Illinois, Massachusetts, Minnesota, New York and Washington because these states have either run out of volume cap or had to ration it in recent years.

These states may not have fully benefitted from the 4% fix because in order to qualify for 4% LIHTCs based on 100% of the eligible basis of the affordable housing at least 50% of the costs of the affordable housing must be financed with tax-exempt bonds. Tax-exempt bonds may only be issued in states with sufficient volume cap; once volume cap is exhausted no more tax-exempt bonds can be issued and no more 4% LIHTCs can be generated until a subsequent year's allocation of volume cap.

Congress has only two ways to increase affordable housing production via 4% LIHTCs in states that lack sufficient volume cap to issue tax-exempt bonds: It can either increase the amount of

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volume cap allocated to states or reduce the amount of tax-exempt bonds required to finance affordable housing projects in order for them to be eligible for 100% of the 4% LIHTC.

The Act permits affordable housing projects financed with tax-exempt bonds issued in calendar years 2022 through 2026 to qualify for 100% of 4% LIHTCs if only 25% of their costs are financed with tax-exempt bonds. Reducing the amount of tax-exempt bonds required for each project should permit states like New York, Florida and California to spread their volume cap among more affordable housing projects and increase affordable housing unit production.

Developers must start doing their due diligence and getting projects in the pipeline or they may miss out on projects in California, Colorado, Florida, Georgia, Illinois, Massachusetts, Minnesota, New York and Washington because the reduction to 25% only lasts for five years.

While developers should actively pursue projects in these states, they must also keep in mind that they cannot use tax-exempt bonds and their accompanying 4% LIHTCs unless they have a reasonable expectation upon close that the affordable housing project will be substantially completed within three years, illustrating all the more why due diligence to identify potential roadblocks must be completed as early as possible. Because there is strong demand for affordable housing in these states, time spent on these projects should be productive.

While the Act reduces the amount of tax-exempt bonds required to be used for each project, it may make tax-exempt bonds slightly more expensive to use because it will most likely impose a 15% alternative minimum tax on corporations that average $1 billion in financial statement income over a three-year period. Previously tax-exempt bonds that were used to finance affordable housing were exempt from the corporate AMT, so interest rates offered will probably increase to reflect this new cost to lenders.

Conclusion

The House of Representatives currently anticipates voting on the Act sometime during the week of Nov. 15. After this vote, developers

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and owners of affordable housing should better be able to focus their attention on the Act's benefits.

The provisions providing federal funding to state and local housing agencies to improve the energy efficiency of affordable housing units and the expansion of the 4% LIHTC program both have limited shelf lives, so developers and owners must be ready to act quickly once the Act becomes law.

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