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Texas Implements a State Low-Income Housing Tax Credit

The state of Texas recently joined the ranks of nearly 30 other states in establishing its own state low-income housing tax credit program (the "Texas LIHTC Program"). Texas H.B. 1058 was enacted on June 13, 2023, and will allow the Texas Department of Housing and Community Affairs (TDHCA) to issue state low-income housing development tax credits ("Texas LIHTCs") beginning January 1, 2024. These Texas LIHTCs can be used to offset franchise taxes and insurance premium taxes on and after January 1, 2026, for companies with an ownership stake in certain affordable housing developments in Texas.

Low-Income Housing Tax Credits Generally

The federal low-income housing tax credit program (the "Federal LIHTC Program") was established by the Tax Reform Act of 1986 to incentivize the new construction or rehabilitation of affordable multifamily rental housing throughout the United States. It allows designated state credit agencies to issue federal tax credits ("Federal LIHTCs") for qualifying projects, which in turn attract substantial equity investment from private investors. To be eligible to receive Federal LIHTCs, which are claimed over a 10-year period, developers must agree to reserve all or a portion of the project's rental units for low-income tenants for at least 30 years. Tax credit investors commit to fund capital for the project (typically in phased installments) in exchange for 99.99% of the Federal LIHTCs. Though a federal program, state agencies are responsible for facilitating and monitoring the distribution of Federal LIHTCs. To further bolster the Federal LIHTC Program and the development of affordable housing, many states have enacted their own state low-income housing tax programs to issue state tax credits to supplement Federal LIHTCs.

Texas State Credit Overview

H.B. 1058 amended the Texas Tax Code and the Texas Insurance Code to establish a franchise tax credit and an insurance premium

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tax credit and directed TDHCA to implement and monitor the new program. TDHCA may issue allocation certificates for state LIHTCs in an open cycle beginning in 2024. However, the new law limits TDHCA's authority to allocate these credits after December 31, 2029. It remains to be seen whether the program will be extended in a future legislative session.

Developments awarded 9% or 4% Federal LIHTCs by TDHCA generally qualify for the state LIHTCs as well, so long as they remain compliant with the federal LIHTC Program, the Texas Qualified Allocation Plan (QAP), and the Fair Housing Act. Like their federal counterpart, Texas LIHTCs must be claimed over a 10-year period. Additionally, a development subject to recapture of its Federal LIHTCs will also have its Texas LIHTCs recaptured in an amount equal to the same percentage of the federal credit recapture. TDHCA is authorized to allocate Texas LIHTCs to a developer in an amount not to exceed that of federal LIHTCs allocated to the particular project. To be entitled to claim the Texas LIHTCs, the taxpayer must be a taxable entity that owns a direct or indirect interest in a qualified development. Developers will be able to apply for Texas LIHTCs as part of their federal LIHTC application submitted to TDHCA.

While not expressly prohibited, it does not appear these credits can be sold or transferred to non-owner entities as may sometimes be the case for other types of state credits, such as renewable energy credits, historic tax credits, film production credits, etc.

The new law limits Texas LIHTCs to $25,000,000 per year—$12,500,000 of which will be available for 4% LIHTC/tax-exempt bond developments, and $12,500,000 of which will be available for competitive 9% LIHTC developments. Those credits, along with credits leftover from the prior year and recaptured/returned credits, if any, will be available for award each year while the program is in effect, subject to any future legislative changes. We want to inform our readers that due to a discrepancy with the associated fiscal note, it is unclear if this $25,000,000 annual ceiling is effective or if the ceiling will instead be determined to be significantly lower. If the latter prevails, the priority set-aside described below may be the only credits awarded during the initial

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year. Stakeholders will be back at the table for the 2025 legislative session and during the interim to advocate for clarification and improvements in future bills to ensure the long-term feasibility of the Texas LIHTC Program as whole.

In today's market where higher interest rates and inflated construction costs are now the norm, developers often find themselves challenged with significant financing gaps for proposed affordable housing developments. To partially address this challenge, during the first year of the Texas LIHTC Program, there is a $5,000,000 set-aside from the state housing credit ceiling for certain prioritized qualified developments. To qualify for priority consideration, a development must meet certain eligibility requirements, namely being that the development received competitive 9% Federal LIHTCs from TDHCA in the 2021 or 2022 QAP cycle and that the land for the development has been owned by the developer since at least December 31, 2022. Developers intending to apply for this priority consideration must notify TDHCA prior to their placed-in-service deadline, in which case the placed-in-service deadline will be automatically extended. More details on this priority Texas LIHTC allocation are expected to be set forth in the QAP.

Another benefit of the Texas LIHTC Program is the ability to carry forward or backward any unused state tax credits. Texas LIHTCs must be claimed in equal installments during each year of the 10-year credit period but cannot exceed the amount of tax due for that year's tax report. Although Texas LIHTCs may not be refunded, Texas H.B. 1058 allows any unused Texas LIHTCs to be carried back three years (but not before January 1, 2026) or carried forward not more than 10 consecutive years following the initial allocation. This provides additional flexibility for project owners to take full advantage of the Texas LIHTC Program, despite not being able to claim the total amount of credits allocated for a particular year.

Lastly, a key component of the new Texas LIHTC Program is that the Texas LIHTCs may be bifurcated from Federal LIHTCs such that the owners of a qualified development intending to claim Texas LIHTCs have the flexibility to agree amongst themselves how they want to apportion those credits (*e.g.*, 100% specially allocated to a state tax

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credit investor even if such investor owns a smaller or even nominal percentage interest). This feature of the Texas LIHTC Program adds valuable flexibility for transaction-structuring and encourages new investors, such as insurance companies, to inject additional equity into these deals. Absent any such agreement among the owners, TDHCA will apportion Texas LIHTCs based on the ownership interest of each partner or member.

Conclusion

The creation of a state low-income housing development tax credit program in Texas provides additional tax incentives for investors to partake in affordable multifamily rental housing. Texas legislators hope that the passage of Texas H.B. 1058 will revitalize the Texas workforce by helping establish additional affordable housing for the state's workers. It is interesting to see the inclusion of the insurance premium tax credit, as this component applies only to companies that are subject to paying taxes on insurance premiums (*i.e.*, insurance companies and brokerages) and thereby incentivizes such companies to be more active investors in Texas affordable housing. As the state-level program goes into effect in Texas, we will continue to monitor its progress and impact on the local multifamily housing market. Furthermore, we will watch the discussions surrounding the annual ceiling for the Texas LIHTCs and will provide an update once there is a resolution.

Frost Brown Todd counsels investors, developers, and other key parties on low-income housing transactions across the country. We are ready to assist clients with navigating the ever-changing legislative environment affecting the industry. For more information, please contact the author of this article or any attorney from FBT's Multifamily Housing team.

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