OBBBA and New Construction: What You Need to Know

Key considerations for housing developers in light of the revised tax code

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Our country is facing a historic housing shortage that seems to worsen each year. The current interest rate environment and rising construction costs have slowed the creation of new multifamily housing.

However, the One Big Beautiful Bill Act that was enacted this past summer made several impactful changes to the Internal Revenue Code. These changes should result in more financially feasible deals, and developers must be ready to kick off the construction process soon.

OBBBA resulted in four significant changes that should increase investor demand. First, it reduced the requirement that at least 50 percent of the aggregate basis of the land and building be financed with tax exempt bond proceeds to 25 percent, which could result in nearly twice as many 4 percent low-income housing tax credit deals starting construction each year.

Second, OBBBA made permanent a temporary 12 percent increase to the pool of available 9 percent LIHTCs that each state can allocate each year, which should maintain the current number of 9 percent LIHTC deals annually.

Third, the Opportunity Zone Program, which provides a mechanism for investors to defer, and in some cases avoid, paying taxes on certain qualifying capital gains, was made permanent.

Finally, OBBBA reinstated 100 percent bonus depreciation for certain property acquired and placed in service after Jan. 19, 2025, which provides an enhanced accelerated depreciation schedule to investors. Ultimately, these changes should result in a substantial uptick in new construction projects. The economic environment and availability of skilled tradesman, however, will ultimately have a significant impact on the number of projects as well.

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As noted above, it is very likely that we will see a substantial increase in the number of new construction starts over the next few years due to increased investor appetite because of certain changes to the IRC resulting from OBBBA. Developers should begin planning their next projects now, and they should keep a few key considerations in mind.

1. On financing

Developers must consider whether they will use construction financing on the project. If so, then in addition to standard KYC diligence and loan document review, developers will need to finalize the terms of the architecture contract and the construction contract. The lender may require a few changes to ensure compliance with the lender's draw procedure and inspection requirements, and these types of revisions can take time. So, start early!

2. Regarding contracts

A project's delivery and billing methods are important to determine early. The project delivery method will outline how the project team will work together in planning, constructing and closing out the project and is something that needs to be discussed during the initial project planning phase. Specifically, a developer must consider whether a single entity will both design and construct the project (i.e., design-build), whether an architect and general contractor will be engaged separately (i.e., design-bid-build), or whether a construction manager will be engaged.

Additionally, for billing methods, a developer must consider whether the contract will be a lump sum contract, a cost plus contract or a guaranteed maximum price contract. Each form has its pros and cons depending on the type of project at hand and it must be considered carefully. For large multifamily developments, a guaranteed maximum price tends to be the form of choice.

3. Insure early

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Developers should begin the insurance process early to ensure that the applicable requirements for any contractor, architect or other member of the project team are satisfied and that any costs to be paid by the developer are reflected in the project budget. Developers must carefully review the policies of their consultants and contractors for any potential exclusions that could be relevant to the project and then address them during contract negotiations.

4. Stay ahead

Depending on a project's construction timeline, a general contractor may need to start work or order materials before the agreements are executed. If this is necessary, then developers may want to consider issuing a limited notice to proceed to help the project stay on schedule while the documents are finalized.

Even though many new construction deals have not been financially feasible over the past few years, new changes to the IRC arising from OBBBA should unlock investor capital. Due to this expected availability of capital, developers should begin planning their next project now and should keep several key considerations in mind during that process, as discussed above.

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