



# TaxCreditAdvisor News, Ideas and Information for Tax Credit Developers and Investors

## **New Study Warns Numerous Communities May Not See LIHTC Rent Increases for Years**

A new study concludes that low-income housing tax credit (LIHTC) rents could stay flat for years in hundreds of communities across the U.S. The problem is largely due to a change in the source of data used by the U.S. Department of Housing and Urban Development (HUD) to compute Fiscal Year 2007 estimates of area median income for metropolitan statistical areas (MSAs) and non-metropolitan counties nationwide. For the FY 2007 estimates, HUD switched to use of data from the American Community Survey, which in many cases resulted in reduced estimates of AMI from the FY 2006 levels.

Each year, for each MSA and non-metropolitan county in the U.S., HUD issues estimates of the median family income for the area, or area median income (AMI). It also issues estimates for the same area, and which vary by household size, of the income limits for extremely low-income, very low-income (VLI), and low-income households. The very low-income (VLI) estimates are supposed to equate to 50% of the median family income or AMI, and are used to determine the tenant income limits and rent limits for LIHTC units. For LIHTC projects that utilize the “40-60” set-aside rather than the “20-50” set-aside (i.e., 40% of the project’s units are reserved for tenants at or below 60% of the AMI), the VLI estimate is multiplied by 1.2 to determine the tenant income limit for an LIHTC unit, which in turn determines the LIHTC rent limit.

However, if an annual change results in a decrease in the AMI for an area, HUD can implement a “historical exception” – more several other possible exceptions can also be tapped –

that prevents the VLI income limit from falling from the level of the previous year, and keep it the same. This effectively “freezes” or “holds harmless” the tenant income limits and rent limits for LIHTC units.

The result of this is that HUD’s income limits for VLI households may actually be greater than 50% of the current AMI for the area. In addition, if the VLI income limits are held harmless for an area, this means that the maximum LIHTC rents won’t be able to rise until the estimated AMI for the area rises to “catch up” to where it had been prior to the decline.

The new white paper prepared by Novogradac & Company, LLP, a San Francisco-based national accounting and consulting firm, examined the HUD annual AMI estimates and VLI limits for FY 2007 and the changes from the FY 2006 figures, for all parts of the country, and sought to quantify the degree of impact for each area.

The white paper found that, as a result of the changes, LIHTC properties in nearly two-thirds of the U.S. may not see rent increases for two or three years, thereby jeopardizing their financial viability. Moreover, it found LIHTC rent increases may not occur for five or more years in nearly 20% of the U.S.

In a news release, white paper co-author Michael J. Novogradac said the study “addresses tax credit housing professionals’ justifiable fears that operating budgets of tax credit properties, which are developed and managed with relatively narrow financial margins, will face ever greater financial pressure. If expenses grow while revenues remain flat, some properties may

eventually be unable to meet debt service. The results of this White Paper clearly demonstrate the need for a legislative or administrative fix; a fix that would allow tax credit properties to increase rents to keep pace with rising operating costs.”

Congressional tax staff has been trying to formulate a possible legislative amendment to the LIHTC program to fix the problem, for possible inclusion in a package of LIHTC amendments to be marked up by the House Ways and Means Committee, possibly in early 2008. (*See p. 1 for related article.*)

The new Novogradac white paper attempts to quantify the degree of adverse impact in individual areas in the country by measuring the “critical gap” – the difference between the very low-income data, and the AMI. This is the income gap that needs to close before LIHTC tenant income limits and maximum rents can rise again.

On a Novogradac Web podcast in early November, Michael Novogradac indicated that more than 70% of the counties in the U.S. showed a decrease in the estimated AMI in the HUD FY 2007 estimates compared to FY 2006. He also noted there were 96 counties that saw allowable LIHTC rents rise by more than 5%, many in Mississippi.

In an interview in mid-October with the *Tax Credit Advisor*, Bethesda, MD Novogradac partner Blair Kincer said Novogradac’s analysis examined the changes between FY 2006 and FY 2007 HUD estimates of AMI and VLI for 2,575 municipalities (MSAs and non-metropolitan counties).

Kincer predicted it will be tougher to develop new LIHTC projects in areas most adversely affected by the changes in HUD income estimates, saying developers and syndicators will need to underwrite new projects much more carefully since they won’t be able to count on rent increases for years. In addition, he said the changes could jeopardize the financial condition of existing LIHTC projects in these same areas, since rents will remain flat, in some cases for years, while expenses continue to rise.

The changes also impact rental housing projects financed by tax-exempt private activity bonds, since HUD’s VLI limits are used to determine tenant income caps for low-income units.

The new white paper, entitled “*Effect of HUD’s Revised Income Calculations on Housing Tax Credit Properties: How Long Until Qualifying Incomes & Tax Credit Rents Rise?*,” is available for purchase from Novogradac & Company, LLP (<http://www.novoco.com>). Purchase of the paper also allows access to an online database of information on which the analysis was based.

The National Association of Home Builders conducted a similar analysis earlier this year of the impact of the changes in annual HUD area median incomes and income limits, which came to similar conclusions about the possibility of widespread adverse consequences for LIHTC properties. (*For story, see the Tax Credit Advisor, July 2007, p. 2.*) □