

**Legislation to Amend the Internal  
Revenue Code to Encourage Investment in Affordable Housing  
Explanation of Provisions**

**Section 1**

**Change the name of the program from the Low Income Housing Tax Credit to the “Affordable Housing Tax Credit.”**

Nearly all housing developments that use housing credits are rented to working families. Many communities are receptive to these types of rental housing, but react negatively to connotations that critics attach to the term “low-income” in the program’s name. This reaction unreasonably empowers affordable housing opponents’ NIMBY (Not in My Back Yard) efforts to block housing projects that would otherwise be acceptable to many communities.

**Set the LIHTC credit percentages at the greater of: 1) current law or 2) 9 percent and 4 percent, rather than using a discounted rate.**

There are two kinds of housing credits for which a project is eligible – the 30% present value credit and the 70% present value credit. For shorthand purposes, these credits are typically referred to as the 4 percent and 9 percent credits, which in the first year of the program was the annual credit percentage awarded to the property each year for ten years. The 4 percent credit is available for the costs of acquiring a building for a rehabilitation project or for the costs of new construction of a project where there are additional federal subsidies being utilized. The 9 percent credit is available for the costs of new construction or substantial rehabilitation of a project (the latter only when a certain minimum is spent for rehabilitation).

The actual credit percentage today is set by the IRS based on current federal borrowing costs -- the Applicable Federal Rate (AFR) published monthly by the Internal Revenue Service (IRS) -- that produces a discount factor that is used to calculate the 30% and 70% present value credits. For many years the credits have been well below 4% and 9%. For buildings placed in service in November 2007 the rates are 3.46 percent and 8.08 percent respectively.

Because the credit amounts adjust monthly, uncertainty is introduced into the property development process so this provision would replace the current law floating rate with a constant 4 percent and 9 percent credit. This would increase the amount of resources available for each project relative to current law as long as interest rates remain low.

**Create a single 9% tax credit for all projects.**

Under current law, the 9% credit amount is reduced to 4% for projects that are financed with federally appropriated dollars (e.g. Rural Housing Section 515 loans, and local or state grant-funded loans that have a below market interest rate). There are

exceptions to this rule, for Community Development Block Grant and HOME funding. However, most housing credit projects require multiple resources to be financially feasible, especially those serving the lowest-income individuals, and are rendered infeasible under this 4% credit limitation. This proposal would allow new construction and substantial rehabilitation expenditures to be eligible for the 9% tax credit even if they are financed using federally appropriated dollars. However, this change would not apply to tax-exempt bond financing. This would enable the development of more projects serving lower-income families and codify the existing exceptions for federal funding programs.

**Give the state allocating agency authority to award 130% credits for properties that meet state-specified geographic or income targeting.**

Under current law, properties located within very low income census tracts, or within areas where housing costs are high relative to income are eligible for a credit that is 130% of the amount that would otherwise apply. This is generally limited to areas that comprise no more than 20% of a state. This proposal would give state allocating agencies broader authority to award higher 130% credit amounts for certain projects based on the state's determination of need. A "state designated project" would be any "project designated by the housing credit agency as meeting such criteria for designation as the State in which the project is located may specify."

**Revise the Housing Credit scattered site rule to allow for mixed-income development.**

The general rule is that for rental units to qualify for housing credits, at least 20% of the property must be rented to households with incomes at or below 50% of area median income, or at least 40% of the units must be rented to households with incomes at or below 60% of area median income. However, scattered site housing projects financed with Housing Credits must be 100% income targeted. This proposal would repeal the 100% requirement and extend the general rule – 20 at 50 or 40 at 60 – to scattered site projects.

**Eliminate the restriction on the use of tax credits for Section 8 Moderate Rehabilitation projects.**

Shortly after the Housing Credit was enacted, Congress enacted a prohibition on using credits with property financed under the Section 8 Moderate Rehab program. This was done following stories that a number of properties receiving mod-rehab funding were significantly over-subsidized by HUD. While the mod-rehab program still exists, no new money has been available for many years and the original over-subsidization problem no longer exists. There is no longer a reason to make this property ineligible. Many of these properties are in need of recapitalization and are finding it difficult to raise capital without the use of housing credits.

**Allow HOME-assisted properties located in qualified census tracts (QCT) or difficult development areas (DDA) to receive the 30 percent increase in eligible basis permitted other properties.**

As described above, property located in very low income areas (QCT) and high housing cost areas (DDA) are eligible for the 130% credit amount. However, credit developments using below-market HOME funding are not eligible for the credit boost. The proposal would allow HOME-assisted Credit developments to receive the 30 percent basis boost permitted all other Credit properties, facilitating construction of the most difficult properties.

**Clarify that certain Federal subsidies will not be considered a grant when determining eligible basis of qualified low-income buildings.**

Current law provides that the amount of Housing Credits awarded to a building is reduced to the extent of any grant of federal funds made with respect to the building. Citing legislative history that “Congress did not intend to treat federal rental assistance payments as grants” Treasury issued regulations in 1997 excluding from the definition of federal grant certain rental assistance payments made to a building owner on behalf of a tenant. Payments are excluded therefore if made pursuant to: (1) Section 8 of the United States Housing Act of 1937 (“the Act”); (2) A qualifying program of rental assistance administered under Section 9 of the Act; or (3) A program or method of rental assistance as the Secretary may designate by publication in the Federal Register or in the Internal Revenue Bulletin.

Following up on that regulation, the Service has subsequently issued guidance excluding three other rental assistance programs from the definition of federal grant, including: payments made to building owners under the Section 8 Assistance for Single Room Occupancy Dwelling Program, and the Shelter Plus Care Program; rental assistance payments under the Housing Opportunities for Persons with AIDS (“HOPWA”) Program; and, rental assistance payments under the 236 program and under section 101 of the National Housing Act.

Those rulings were based on specific requests by affected organizations. Meanwhile, a number of other federal housing programs providing rental assistance under substantially identical rules have not received clearance from the IRS, and there is some confusion whether they could be considered a federal grant.<sup>1</sup> This provision would clarify that those payments do not serve to reduce the amount of Housing Credits that a property is eligible for.

**Base rural rent/income ceilings on greater of: 1) current law or 2) 60% of national non-metro median income.**

---

<sup>1</sup> Rural Development Rental Assistance, Rural Development Interest Credit Subsidies, HUD Section 236 Interest Reduction Payments, HUD Section 202 Project Rental Assistance Contracts, NAHASDA (Native American Housing and Self-Determination Act), Supportive Housing Program leasing payments and operating cost payments, Section 202 and Section 811 project rental assistance contracts, HOME tenant based rental assistance, HOPWA (Housing Opportunities for People with AIDS) operating subsidies, VA per diem payments.

## DRAFT

Because incomes are so low in many rural areas, it is exceedingly difficult to develop affordable housing property since the rents necessary to support the property are so low. This proposal would facilitate development of affordable housing in rural areas by permitting states to target tenants at 60% of the national rural median income rather than 60% of area median income.

### **Repeal the ten year rule for acquisition Housing Tax Credits.**

Under current law, existing property is not eligible to be redeveloped with the use of Housing Credits if it has been transferred within the previous ten year period. This rule was originally adopted in 1986 because of a concern that generous accelerated depreciation would encourage churning of property to obtain tax benefits. Given the 27 and one half year depreciation period currently in place for residential property, that should no longer be an issue.

### **Expand the allowable basis for community service facilities.**

Under current law, common space eligible for Housing Credit assistance as part of a property can only be used for tenants subject to one exception. The exception applies to community service space that can comprise no more than 10% of the space of the property and which is designed for use by individuals who would otherwise be eligible to live in the property based on income. Community space for such activities as child care and elderly programs is in short supply in many areas. This proposal would expand the allowable basis for community service facilities to facilitate use in smaller properties. The proposal would allow 20 percent of first \$5 million of eligible basis and 10 percent thereafter.

### **Eliminate the requirement for the annual recertification of tenant incomes in 100% Housing Credit properties.**

Under current law, building managers are required to annually certify the income of tenants living in Housing Credit properties. This is true even in properties that are 100% targeted to eligible tenants even though the law does not require that tenants be evicted if their income rises above 60% of area median income. Currently the IRS permits a waiver process, but not all states participate so many properties today are required to certify tenant income annually although it serves no purpose. This provision would repeal the annual certification of tenant income for properties that are 100% targeted to eligible tenants.

## **Section 2 – Mortgage Revenue Bonds**

### **Repeal the ten year rule for mortgage revenue bonds.**

Under current law, state housing finance agencies are required to use mortgage revenue bond payments to retire mortgage revenue bonds that are ten or more years

old. This reduces the volume of MRB bonds that a state may issue preventing tens of thousands of qualified lower-income, first-time home buyers from benefiting from affordable MRB-financed mortgages. The provision would repeal the rule for MRBs issued after date of enactment.

### **Section 3 – Conforming Multifamily Housing Bond Rules to Housing Credit Rules**

#### **Conform the “next available unit rule” used for tax-exempt bond properties to the rule used for LIHTC properties.**

The next available unit rule provides that once tenant income exceeds 140% of the income limit for the property, the next available unit that is not income targeted must be rented to qualified tenants. The rule applies to each building separately for LIHTC purposes, but to the entire project for multifamily housing bond purposes, creating complications for building managers when the two subsidies are combined. The provision would conform the bond rule to the Housing Credit rule.

#### **Conform the definition of “student” used for tax-exempt bond properties to the definition used for LIHTC properties.**

The general rule for the Housing Credit program is that students are not qualified tenants. However, there are exceptions to that rule for certain students, including married students, students receiving public assistance, or person enrolled in certain job training programs. This provision would extend those rules to the multifamily housing tax-exempt bond program when the two subsidies are combined.

#### **Extend the LIHTC rule for SRO housing to tax-exempt bond properties.**

The general rule is that Housing Credit and multifamily housing bond property cannot be used as transient housing. However, section 42 provides that single room occupancy units rented on a month-by-month basis will not be considered to be used on a transient basis. This provision would extend the rule to multifamily housing bond properties.

### **Section 4 – Mortgage Revenue Bonds**

#### **Permit displaced homemakers, single parents, and certain disaster victims to be treated as first-time homebuyers under the mortgage revenue bond program.**

The first-time homebuyer requirements under the MRB program would be waived for individuals whose primary residence was rendered uninhabitable and was located in a presidentially declared disaster area. The first-time homebuyer requirement would also be waived for single parents and “displaced homemakers”, defined as an adult who has not worked full-time for a number of years outside the home, and is unemployed or underemployed. The provision is effective for bonds issued after date of enactment.

**Section 5**

**Repeal the recapture bond rules of the Low-Income Housing Tax Credit.**

Under current law, an investor who transfers an interest in a Housing Credit property is required to post a bond with the Internal Revenue Service that serves as a guarantee that recapture taxes will be paid should the property not be in compliance with the rules in Section 42. This is a unique provision in the Tax Code that requires that a potential tax liability be covered by a surety bond. According to a fall 2003 letter from the IRS, there has never been a collection on a recapture bond. Furthermore, there is no public policy rationale for such a requirement that often has the result of interposing a lower credit rating surety bond company as a guarantor for a potential tax payment by a higher credit rated financial institution that invests in Housing Credits. This provision would replace the recapture bond requirement with two new rules: 1) The current law three-year statute of limitations for Housing Credit violations would be replaced with a longer statute of limitations extending to three years after the end of the compliance period for the property. 2) Owners of housing credit properties where there has been a recapture event would be required to file information returns with the Secretary of the Treasury upon the occurrence of a recapture event and to provide persons who are named in such returns with specified information. This provision is identical to legislation that was introduced in 109<sup>th</sup> Congress in the House (H.R. 1468) and in the Senate (S. 2366).

**Section 6**

**Exempt Affordable Housing Tax Credits from the alternative minimum tax.**

This provision would permit individuals and corporations who are AMT taxpayers to utilize Housing Credits to reduce their alternative minimum tax liability. The provision would be effective for taxable years after the date of enactment.

**Section 7**

**Exempt interest income received on mortgage revenue bonds, veteran mortgage bonds, and multifamily bonds from the alternative minimum tax.**

This provision would exempt interest income from mortgage revenue, veteran mortgage, and multifamily bonds from inclusion in income under the AMT. It would be effective for bonds issued after the date of enactment.

**Section 9**

**Modify the related party rule under purchase and placed-in-service rules for existing qualified low-income buildings.**

## DRAFT

Under current law, there cannot be more than a 10% identity of interest between a seller and a buyer of Housing Credit property. This 10% related party rule is in contrast to the general rule in the Tax Code which defines related parties as having more than a 50% common interest. This could create significant problems in the future as some Housing Credit properties are recapitalized to help serve affordable housing needs in the nation. Because there has been such a consolidation of investors in the industry, it will be increasingly difficult to avoid the low 10% overlap threshold in current law. For example, last year approximately 70% of the equity capital raised in the Housing Credit program came from the 17 largest investors. Based on those numbers, it will not be uncommon for properties sold by one investor syndicate to another investor syndicate to have more than 10% common ownership. The provision would conform the related party test in Section 42 to the general rule in the Code, raising the 10% relationship test to 50%.