State Tax Credit Programs Grow in Number, Acceptance - But Clouds are on the Horizon

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As reported in the LIHC Monthly Report in January, state low-income housing tax credit (state LIHC) programs have been growing in popularity. More states have been adopting state LIHC programs and more investors have been learning of the benefits they offer. As a result, the value of state credits has generally improved. In spite of growing investor acceptance, there are some reasons to be concerned about the future of state LIHC programs.

At the center of growing investor acceptance are the successes of the tax credit program: the more than 1 million rental apartments, the relative health of the real estate industry and a continuing, huge demand for affordable housing.

California, a state with exceptionally high housing costs, created a state tax credit program back in 1986 as a means to supplement the federal credit. The annual credit ceiling was raised from $35 million in 1998 to $50 million in 2000 (A.B. 1626). That amount was raised, with the passage of Senate Bill 73, to $70 million in 2001 and in each year thereafter. "The more tax credits there are, the more potential for equity," California State Treasurer Philip Angelides, chairman of the California Tax Credit Allocation Committee, said in a recent interview. Angelides notes that California's state tax credit program has produced more than 100,000 units of affordable rental housing.To attract major, quality investors, state tax credit programs need to offer economic efficiencies. Shorter credit periods and bifurcation of state credits are ways to attract investors. While many states' credit periods mirror the 10-year credit period of the federal tax credit, California's four-year credit period, and Massachusetts' five-year period are notable exceptions. Georgia and North Carolina, among others, allow federal and state credits to be bifurcated and sold to separate investors. This allows tax credit investors to take either the state or federal credit, depending on their tax situation.Some professionals also believe that certain similarities between state and federal tax credit programs hold the key to successful programs. According to George Barry, of Foss and Company in San Francisco, compliance and recapture would be more manageable if a state program mirrors the federal program.

Budget deficits and the lack of bifurcation in many states have led many affordable housing advocates to be concerned about the future of state LIHC programs. As states look to balance their budgets, state LIHC programs may see cutbacks. Furthermore, states that do not allow bifurcation of the state and federal credits may find a shortage of investors. Investor shortage may lead to lower than anticipated tax credit equity value.

Unfortunately, California, a leader in early creation of a state LIHC, does not allow bifurcation, thereby eliminating all non-California taxpayers from the pool of potential investors. This limitation could have a severe effect on the demand this year for some California LIHC funded developments.

The affordable housing industry needs corporate giants like insurance companies, banks and other major investors for its success. What investors require in return is a sound, flexible state LIHC program from which they can generate solid yields, even in a shaky economy. Given the proper tax incentives, dependable yields, and confidence that a program will achieve its goals, investors will clamor for credits. Poorly designed state LIHC programs, in a period of state budget deficits, could face poor investor demand and severe funding cuts.

For the complete story on the state tax credit and a detailed list of those states offering it, be sure to read next month's LIHC Monthly Report. The information will also be available at www.taxcredithousing.com. ❖

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