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Obama Budget Proposal Includes Major Increase in LIHTC Resources

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President Barack Obama released his fiscal year 2016 (FY 2016) budget proposal Feb. 2, but it wasn't a Groundhog Day moment for the tax credit community. Obama's proposal included some significant changes from past budgets, including a nearly \$4 billion increase in the low-income housing tax credit (LIHTC) program and proposals to make the new markets tax credit (NMTC), renewable energy production tax credit (PTC) and investment tax credit (ITC) permanent.

Most budget commenters often pronounce the president's budget request as "dead on arrival." And it is true that many of the high-profile provisions have strong opposition from leading Congressional Republicans. However, a president's budget proposal is always meaningful, even if it will have significant changes before implementation—particularly when Congress is controlled by the opposite party. It serves as the starting point for negotiations. This year, it takes on added weight in light of the eagerness of many in Congress to pursue significant business tax reform.

That was immediately one of the hot issues for the 114th Congress, as the House Ways and Means Committee took former Chairman Dave Camp's proposals from last year as a reference point. Over in the Senate, Finance

Committee Chairman Orrin Hatch, R-Utah, and Ranking Member Ron Wyden, D-Ore., announced five tax-reform working groups in mid-January, including the community development and infrastructure group, which has jurisdiction over the LIHTC, NMTC and historic tax credit (HTC). That committee will be led by Sen. Dean Heller, R-Nev., and Sen. Michael Bennet, D-Colo. The business income tax reform working group will have jurisdiction over the ITC and PTC and will be led by Sen. John Thune, R-S.D., and Sen. Ben Cardin, D-Md. It is worth noting that Sen. Bennet is the ranking member of the Finance Subcommittee on Energy, Natural Resources and Infrastructure, which has formal jurisdiction over the RETCs and HTC, and Sens. Thune and Cardin have been strong supporters of the PTC.

It will be months before any of the groups are ready to present tax reform legislation—if any—but the administration's budget request was an indication of what Obama considers most important.

PAB Cap Conversion a Significant LIHTC Bump

Obama's proposals were part of a \$4 trillion budget request, of which there was \$1.09 trillion in discretionary spending, an increase of \$74 billion from the budget caps set by

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Bipartisan Budget Act of 2013 and the Budget Control Act of 2011. The item that would affect the LIHTC community most significantly is a proposal to allow states to increase their LIHTC authority by converting up to 18 percent of their private activity bonds (PAB) volume cap into LIHTC allocations, potentially increasing allocable LIHTCs by as much as approximately 50 percent. The Bipartisan Policy Center has previously urged Congress and the administration to increase the LIHTC by 50 percent. The U.S. Office of Management and Budget (OMB) estimates the cost of this bond conversion proposal as \$3.7 billion over 10 years, which means it makes up about 93 percent of the nearly \$4 billion cost of all of the LIHTC proposals in the FY 2016 budget. However that cost of the bond conversion proposal is much less than a straight 50 percent per-capita allocation increase would be. As always with budget proposals, the significance is not just in what is proposed, but in the direction of spending and in this case, the administration is going from requesting a 10-year cost of \$1.3 billion in FY15 LIHTC proposals to nearly \$4 billion this year.

The bond conversion rate would be \$1,000 times twice the applicable percentage of the 30 percent present-value LIHTC from December of the previous year. Using that formula at the applicable percentage from December 2014, states could increase their LIHTC authority by \$64.40 for every \$1,000 of PAB cap. The purpose of the proposal is a desire by the Obama administration to allow states to issue more LIHTCs at a lower cost than it would by increasing per-capita LIHTC allocations.

While the LIHTC allocation increase from the bond conversion proposal would divert existing state resources—some would prefer a direct per-capita increase in allocation authority, for instance—that’s still a significant jump.

Other LIHTC Proposals

Many in the LIHTC community hoped the administration would propose an extension of the minimum 9 percent LIHTC rate, but it repeated its proposal from last year, advocating a revision in the formulas used to produce monthly allocated credit percentages. Under the proposal, the discount rate used to determine the credit rate would be the average of the midterm and long-term applicable federal rates for the relevant month, plus 200 basis points—an effort to make the rate more responsive and more closely mirror the investor cost of borrowing, rather than

the government’s cost of borrowing. At current interest rates, this percentage would have been 8.13 percent for the month of February, an 8.8 percent increase over the February floating rate of 7.47 percent, but 9.7 percent less than the 9 percent LIHTC rate floor.

Another significant change in the LIHTC is a new proposal to remove the qualified census tract (QCT) basis boost population cap. In general, a 130 percent basis boost is available for properties in QCTs designated by the U.S. Department of Housing and Urban Development (HUD). QCTs are areas with poverty rates at or above 25 percent or where 50 percent of the households in the tract have median incomes at or below 60 percent of the area median income (AMI). However, there is a cap on QCT designations if the population of all of the qualifying tracts in a metropolitan area exceeds 20 percent of total metropolitan area population. The proposal would remove that population cap and enable more properties in more areas within a metropolitan area to receive the 130 percent boost.

Significant in this year’s budget proposal is something that was missing after making appearances for the past several years: A proposal to enable real estate investment trust investors (REITs) to benefit from REIT investment in LIHTCs. In recent budget years, the administration sought to provide an incentive for REITs to invest in LIHTCs by allowing them to designate a portion of their dividends as tax-free, an amount equivalent to the LIHTCs divided by the highest corporate tax rate. The administration developed that proposal in the wake of the financial crisis of 2008-2009, which sharply decreased investor interest in the LIHTC. As the LIHTC investment market has consistently remained robust over the past few years, that proposal went away this year.

RETC Proposals

Perhaps the biggest turnabout for the FY 2016 budget compared to Obama’s FY15 budget request was a proposal to make the ITC permanent. Last year, Obama’s budget proposal sought to allow the 30 percent ITC to expire at the end of 2016 and repeal the 10 percent credit after 2016. This year, the proposal is to make the ITC permanent at 30 percent, paired with permanence for the election to claim the ITC in lieu of the PTC. The administration also once again called for an extension of the PTC that expired at the end of 2014 and to make it permanent and refundable

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starting Jan. 1, 2016. The other significant part of the PTC proposal would be to make it available to renewable energy used directly by the producer, rather than sold to an unrelated third party. The production would have to be independently verified, but that expands the amount of electricity eligible for the PTC.

Looking at the big picture, the language in the budget proposal to allow the taxpayer to claim the PTC in lieu of the ITC reflects a continued policy shift encouraging subsidizing energy as it's produced, rather than a cost-based credit.

Make NMTC Permanent, Propose MCTC

The administration also followed its tradition by proposing to make the NMTC program permanent at a \$5 billion annual level. The proposal included allowing NMTC amounts from qualified equity investments (QEIs) made starting this year to offset taxpayers' alternative minimum tax (AMT) liability. That the NMTC, in addition to the PTC and ITC, is one of the few credits proposed for permanency should be welcome news to those involved in community development, although there remains a significant road ahead to get the credit made permanent through Congress. Congress—led by Reps. Pat Tiberi, R-Ohio; Richard Neal, D-Mass.; and Tom Reed, R-N.Y. in the House, and Sens. Roy Blunt, R-Mo.; Chuck Schumer, D-N.Y.; Steve Daines, D-Mont.; and Ben Cardin, D-Md.—took a significant first step on that road. Tiberi, Neal and Reed introduced H.R. 855 to make the NMTC permanent in early February and the senators were expected to propose similar legislation in their chamber.

The administration also continues to advocate for a new, related tax credit, the Manufacturing Communities Tax Credit (MCTC), a \$2 billion total credit for investments in communities that suffer from a major job loss event from the loss of manufacturing facilities or base closures in 2016-2018. The administration has not yet proposed a specific structure for the MCTC, but it suggested it could be modelled after the NMTC.

What's Next?

As always, the president's budget proposal is significant step in the budget—and this year, the tax-reform—process. We will see what proposals come from the Republican-led Congress and whether leaders will choose to use reconciliation—which protects budget legislation from filibusters and allows a simple Senate majority to pass legislation that doesn't increase the deficit beyond a 10-year budget window—to pass significant legislation. With a technical deadline of April 15 for a budget resolution unlikely to be met (the last time Congress passed both a concurrent budget resolution and all spending bills on time was 1996), we will likely see a Congress begin to seriously pursue budgetary and tax-reform issues this spring and continue into the summer. Indeed, House Ways and Means Committee Chairman Paul Ryan, R-Wis., told Bloomberg that “the time to find common ground [on business tax reform] is coming this summer.”

The Obama administration's proposed expansion of the LIHTC program and its suggestion to make the NMTC, PTC, and ITC permanent is a strong statement from the administration on its tax reform priorities as that process begins. ❖

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