NOVOGRADAC
TAX CREDIT TUESDAY
PODCAST

Summary: September 1, 2020

In this week's Tax Credit Tuesday podcast, Michael J. Novogradac, CPA, shares a brief update on the next round of COVID-19 relief legislation. Then, he discusses a significant milestone for the Novogradac Opportunity Funds List concerning reported equity investment in opportunity funds. Next, he talks about what you need to know about fair market rents for fiscal year 2021, and he then outlines key considerations for low-income housing tax credit awardees. He wraps up with discussion of an announcement from the White House on an executive order meant to increase activity in opportunity zones.

Summaries of each topic:

GENERAL NEWS

COVID-19 Negotiations Stalled

Negotiations unfortunately remain stalled concerning the next round of COVID-19 relief legislation.

As the impasse continues between House Democrats and Senate Republicans, it's looking more likely that any further COVID-19 relief will be paired with a continuing resolution to fund the federal government past the Sept. 30 deadline through the election.

This disagreement on how to address COVID-19 relief has also stalled progress on tax incentive proposals that could be included in COVID-19 legislation—proposals, such as:a minimum 4 percent low-income housing tax credit rate and a permanent new markets tax credit.

I'll report any updates on negotiations in future podcast episodes.

Opportunity Funds List Update

Next, I have an update on the amount of equity reported invested in funds on the Novogradac Opportunity Funds List.

The updated total now surpasses $12 billion, $12.05 billion to be exact. That's nearly $2 billion more than our previous update, in April. That is a 19.4 percent increase in reported investment over four months.

Last week, we talked about a report on opportunity zones investment from the White House Council of Economic Advisers, or CEA. The CEA report used Novogradac data and extrapolated that data to conclude that there had been $75 billion in investment by the end of 2019. This CEA extrapolation is based on Novogradac data from before our $12 billion investment milestone and the CEA extrapolation is also based on information about qualified opportunity funds on the Securities and Exchange Commission website.

The Novogradac data is based on actual public and private reports from opportunity funds as opposed to being an extrapolation.

Our list of opportunity funds that we are tracking has grown to 811 funds. This reflects a 31 percentincrease from our April level of 621 funds. Within that 811 funds, 580 of the funds have public or privately reported raising equity, with an average raise of $20.8 million. This level of 580 funds is 43 percent higher than the April level of 406 funds having reported raising equity.

Of course, the actual amount invested is significantly higher than $12 billion and we do have the CEA estimate of $75 billion. The Novogradac list is $12 billion and the reason we think it's so much higher is because the Novogradac list includes single- and multi-asset funds, but does not include proprietary funds or private funds.

Also, our survey is a rolling survey, so we have various reported amounts based upon different dates. However, the Novogradac list is a good way to track trends and to see what types of investments are being made.

Here are some high-level observations, based on our latest update. Opportunity funds that are focused on residential and commercial investments are still raising the most equity. Opportunity funds with at least a partial focus on residential development have raised about 75 percent of the total equity.

Funds with at least a partial focus on commercial development have raised about 58 percent of the overall total. Of course, those numbers add up to more than 100 percent because there are many funds focus on multiple areas of investment.

We also in our recent blog post broke down the top states for investment. This is not a list of where the opportunity funds themselves are located, but where the funds are investing their equity.

Not surprisingly, California and New York are the top two states for investment. Ohio, Arizona and Georgia round out the top five states for investment. Ohio has a 10 percent state opportunity zones tax credit, so that does appear to be a major factor in attracting investment to Ohio.

I wrote a blog post that also offers information about the geographic focus of the funds and the top two cities for investment overall. You can probably guess what the top two cities are overall: New York and Los Angeles. I will provide the link to the blog post in today's show notes, and I'll tweet it out as well.

And we'll be talking about this at the Novogradac 2020 Opportunity Zones Virtual Conference. That conference is Oct. 22-23. I'll share a link to register for that conference in today's show notes and tweet it out as well. And if you have ideas about topics we should cover at the virtual conference, please send an email to cpas@novoco.com or send a tweet to @Novogradac.

FY 2021 Fair Market Rents

HUD released 2021 fair market rents in mid-August, which was more than two weeks earlier than the mandated date of Sept. 1. These FMRs, as they're called, are effective Oct. 1 for all areas with the exception of those that request re-evaluations.

The FMR is the amount needed to pay rent and utilities at a privately owned, decent and safe rental housing unit of a modest nature with suitable amenities—hence fair market rent.

FMRs are used to determine payment standards for the Housing Choice Voucher program and initial renewal rents for some expiring project-based Section 8 contracts. FMRs also affect rent determinations for other HUD rental assistance programs. FMRs also influence the income and rent limits for low-income housing tax credit housing.

The big news is that FMRs for 2021 are largely unaffected by the COVID-19 pandemic. The reason the COVID-19 pandemic did not affect the FMRs is based on how FMRs are determined—not because COVID-19 isn't affecting rents. The American Community Survey data, which serves as the basis for the calculation of FMRs, is from two years ago.

That means that the pandemic was not a factor in the American Community Survey data. In doing the FMR calculation, HUD uses the five-year American Community Survey estimates for two-bedroom rents. That five-year period in this case for 2021 FMRs are the years 2014 through 2018. HUD adjusts from 2018 to 2021 using other factors.

So let's look at the big picture as to what we know from these released FMRs.

Eighty-five percent of areas will see an increase from their 2020 FMRs. A year ago, only 59 percent of areas had an increase.

Some more details, again at a high level: The average increase in FMRs for 2021 is almost 3.4 percent, but 29 percent of areas will see an increase of more than 7.5 percent. Only 2 percent of areas will see a decrease of more than 5 percent. Six areas have more than a 15 percent increase in their FMR. And you probably won't guess the top increase. The top increase is for Redding, Calif. Redding's FMRs will go up more than 26 percent.

So how will this affect low-income housing tax credit properties?

First, FMRs are a driving factor in determining if an area will have its income limit increased due to the high housing cost adjustment. HUD applies a high housing cost adjustment for areas where the cost of housing is an abnormally high percentage of median income.

My partner Thomas Stagg wrote a recent blog post about this issue.

In the blog post he noted that having applied the high housing cost adjustment through the Novogradac Rent and Income Limit Estimator he determined the following: Thomas determined that 170 counties will be affected by the high housing cost adjustment. The income limits in these counties may still be increased by another adjustment from HUD, but their limit will be no less than what is determined based on these FMRs.

The second way the FMRs will affect low-income housing tax credit properties is that an increasing payment standard can benefit developments that have tenants using Housing Choice Vouchers.

It's worth noting that FMRs and small-area FMRs also affect difficult development areas, or DDAs, and small DDAs. DDAs are determined by the ratio of FMRs to area median incomes. And areas with the highest ratio containing 20 percent of the nation's population are DDAs.

As I noted earlier, the FMRs take effect Oct. 1 and the 2021 rent and income limits will be announced next spring, around April 1.

If you own or manage a low-income housing tax credit property, the key news is that Housing Choice Voucher rents will likely go up next year. And if you are in a high housing cost area, your LIHTC income and rent limits will likely increase. It isn't mandated that you raise rents, but increasing income limits will make it easier for residents to qualify for rent and income restricted housing.

Also, we won't likely see the effects of the pandemic on FMRs or high housing cost adjusted income limits for two years, in 2022. That's when the 2020 data will finally be used to determine fair market rents. Until then, we'll be operating in an economy that has slowed down, but where FMRs and potential income limits are increasing.

If you have any questions about how the fair market rents will affect your properties, please contact Thomas or another Novogradac partner near you.

You can also purchase the Novogradac Rent and Income Limit Estimator. The estimator will give you insight into how income and rent limits in your area or areas are projected to change over the next 1-2 years. This is vital information that should be part of every underwriting model for low-income housing tax credit properties.

I'll include a link to purchase the Novogradac Rent and Income Limit Estimator in today's show notes, as well as a link to Thomas' blog post on fiscal year 2021 FMRs.

LIHTC Post-Award Regulatory Considerations

I said earlier that I'd have two important blog posts to bring to your attention.

The second post is a timely and useful reference for low-income housing tax credit applicants. More significantly, low-income housing tax credit awardees.

Last week on Tuesday, my colleague Mark Shelburne published a Notes from Novogradac blog post on a number of regulatory points developers should consider after receiving a low-income housing tax credit award.

I'll go over some of the highlights of the blog post here, and I'll include a link to the blog post in today's show notes for you to review in detail.

I mentioned that the blog post is timely. That's because many low-income housing tax credit allocating agencies complete their review of applications around this time, late summer and early fall. Some states, such as Oregon, have already announced their low-income housing tax credit awards for this allocation round. Other states are preparing to make their announcements soon.

If you receive a low-income housing tax credit award this year, let me start by saying congratulations. After celebrating your success, be sure to keep in mind various post-award expectations.

In his blog post, Mark offers three overarching principles to consider: The first principle is that almost everything is better and easier when addressed early on, so act early. Second, remember to communicate with all relevant parties frequently, and include the allocating agency in those communications. The third principle is that certain shortcomings or failures to meet requirements can be difficult or impossible to correct. The worst of these are pass/fail requirements known as "cliff tests." Failing these cliff tests means the awarded low-income housing tax credits automatically go over a figurative cliff.

In addition to these three general principles, the blog post outlines specific pitfalls to avoid.

For example, one of the challenges of communication is knowing who will handle post-award tasks. Some larger entities structure their staff by dividing team members between those securing approvals and funding sources and those doing work after the buildings are placed in service. Sort of development versus operations. This split in staff makes sense, but can leave unanswered questions about the interim, post-award period. Designating an individual or team to handle post-award tasks can clarify responsibilities.

Another tip is to look back at your state's qualified allocation plan to review a few specific details, such as: The fees due, including what is often a six-figure allocation or reservation fee; deadlines, both federal and those specific to the state agency as well as upcoming documents to submit. These requirements are crucial and not complying with them could result in delays, fines or other penalties.

Another pointer during the post-award period is to review rules and regulations for any additional gap funding sources you may be using. Remember that different rules and requirements may apply, depending on your additional sources. It's important to review all of the requirements for any additional funding before starting site work.

Also, remember that you generally have 12 months from the carryover agreement's effective date to meet the 10 percent test. The 10 percent test is the requirement for low-income housing tax credit property owners to expend at least 10 percent of the property's reasonably expected basis. Twelve months is the federal requirement. Some allocating agencies have a shorter timeframe to meet the 10 percent test.

There's also a placed-in-service requirement. The buildings must generally be ready and available for intended use—or placed in service—by Dec. 31 two years after the carryover agreement's effective date.

Those are just a few of the many considerations to keep in mind after receiving a low-income housing tax credit award. Consulting a qualified and experienced tax practitioner can help you avoid post-award pitfalls.

If you receive a low-income housing tax credit award and need assistance with next steps, remember that Novogradac is here to help. We have experts who can assist you in any state, so please contact a Novogradac office near you.

If you'd like to learn more about the low-income housing tax credit and various requirements, consider registering for the Novogradac 2020 Credit and Bond Financing for Affordable Housing Virtual Conference. The conference is Oct. 1-2 and will be held virtually.

Novogradac will also host a pre-conference workshop Sept. 17 to prepare attendees for post-tax-credit award requirements. The pre-conference workshop is called LIHTC 202: Allocations to 8609s. Separate registrations are required for the conference and the pre-conference workshops, so please be sure to register for both. I'll include registration links for the conference and pre-conference workshops in today's show notes.

OTHER NEWS

In other news, President Donald Trump on Thursday last week issued an executive order meant to increase activity in opportunity zones. How does he do this?

Under the executive order, federal agencies shall give preference to opportunity zones, distressed communities and centralized business districts when considering where to locate their offices and other facilities. While this order is directed at federal agencies, opportunity zones communities and stakeholders can benefit from increased investment in these distressed areas.

You can learn more about public and private efforts to increase opportunity zones investments at the Novogradac 2020 Opportunity Zones Fall Virtual Conference, Oct. 22-23. I'll include a registration link for the conference in today's show notes, as well as a link to the executive order.

Related Resources

Opportunity Funds List

Blog post: Novogradac Opportunity Funds List Surpasses $12 Billion in Investment

Novogradac 2020 Opportunity Zones Virtual Conference

FY 2021 FMRs

What You Need to Know About HUD's FY 2021 FMRs

Novogradac Rent & Income Limit Estimator ©

LIHTC Post-Award Requirements

LIHTC Post-Award Regulatory Considerations

Register for the Novogradac 2020 Credit and Bond Financing for Affordable Housing Virtual Conference

Executive Order

OZ Executive Order

HTC Conference

Register for the Novogradac 2020 Historic Tax Credit Virtual Conference