STATE LOW-INCOME HOUSING TAX CREDITS: RECOMMENDED PRACTICES & CONSIDERATIONS

The Affordable Housing Tax Credit Coalition is a trade association of housing professionals who advocate for affordable rental housing financed with the federal Low-Income Housing Tax Credit (Housing Credit). Our more than 250 members—including syndicators, investors, lenders, developers, legal and accounting professionals, state allocating agencies, public agencies, and coalitions—seek to preserve, expand and improve the Housing Credit. Collectively, AHTCC members have financed or developed well over half of all affordable housing nationwide.

AHTCC members are increasingly financing affordable housing that pairs the federal Housing Credits with state Housing Credit programs. To increase affordable housing production, over 25 states have now created state tax credit programs that supplement the federal Housing Credit. The rules and regulations of these programs vary from state to state, and each state's experience provides valuable lessons as new states consider implementing state Housing Credit programs.

Below is a summary of recommended practices and considerations when implementing a state tax credit program, drawing from AHTCC members' extensive experience with state Housing Credit programs.

RECOMMENDED PRACTICES

Keep it simple. As a general rule, the more discretion a state housing finance agency (HFA) can exercise in its qualified allocation plan (QAP), which governs the administration of the Housing Credit in the state, the better. Set-asides and other priorities should be left to the QAP framework, not statute. Statutes are much harder to change than QAPs.

Issues that should be left to state discretion in their QAPs, in recognition that local needs will change from year to year, include:

- The ability to pair the state tax credit with the 9% and/or 4% federal Housing Credit
- Geographical distribution between rural and metro areas and other local factors
- Application timing and structure, which will ideally mirror the federal program where possible
- Application scoring, which will also ideally mirror scoring for the federal program where possible
- The minimum allocation per development
- Post-award documentation requirements

Build upon the existing federal Housing Credit program. State HFAs and the Housing Credit industry have a very evolved, robust knowledge of a very successful, yet complex program. Federal Housing Credit qualification, basis, compliance and other program tenets should be incorporated into state tax credit programs. Using the same infrastructure as the federal program will reduce the cost of administering a state program and minimize the possibility of conflicts between the two programs.

Provide a sufficient, reasonable amount of state Housing Credit authority. States should authorize enough state tax credit authority to have a meaningful impact on the state's affordable housing goals. It is also important to only offer enough state tax credit per development as needed for financial feasibility, so as to make optimal use of limited resources. Often, a one-for-one match between the state credit and the federal credit is used to provide an appropriate level of resources.

Take steps to increase investor appetite. Often state tax credit programs have different investors than the federal Housing Credit. Because state tax rates are lower than federal tax rates, any individual corporate investor will have less state tax credit appetite than it will for the federal Housing Credit. To drive up demand, the following should be considered:

- **Allow bifurcation from the federal credit.** Federal Housing Credit investors may have no interest in a state tax credit, yet they will want the maximum federal credit from a particular development. Allowing a state credit partner to receive 100% of the state credits, yet little or no federal credits, will increase investor appetite. The receipt or transfer of the state housing tax credits by the taxpayer issued the reservation of state housing tax credits should not be a taxable event for purposes of the State income tax.
- **Offset a broad array of state taxes.** To further broaden the investor base, it is important to offset multiple taxes (e.g. individual income, corporate income, insurance premium, insurance retaliatory, corporate franchise and other state taxes, as applicable).
- **Get the statute right from the start.** The clearer the statute, the less additional policymaking will be needed to implement the credit. Work with national tax and legal experts in crafting local legislation. Local legislative experts may not fully understand the complex Housing Credit and other federal tax issues around state tax credits. Establish communication channels between the state HFA and those drafting the legislation to ensure the credit will be operational as intended. Take steps to ensure the HFAs and others who are called upon to provide guidance to policymakers are well versed in state tax credits and involving the appropriate experts.
- **Do not condition redemptions on Form 8609 (or equivalent) approval.** Developments often earn federal Housing Credits prior to state HFA approval of the Low-Income Housing Credit Allocation and Certification (Form 8609), and federal investors have come to rely on their ability to claim credits from the early stages of a project. Approvals of Form 8609 are often subject to delays, which do not reflect the actual status of the development. As a result, investors have been pursuing an approach of claiming federal Housing Credits even without the Form 8609 so long as the delay is from a "reasonable cause" and not willful neglect. State taxing agencies may be less flexible. States should allow investors to claim credits when earned, rather than when 8609s are issued, to allow state credit redemption expectations to operate more like the successful federal Housing Credit program.
- **Allow for maximum flexibility in the investor market.** Often state credit investors may not want the full stream of credits over the 10-year federal Housing Credit period. Allowing syndicators to be flexible in matching state credits to investor demand will increase pricing. Often this means that the investor who claims state credits generated by a particular project will change from year to year.
- **Talk to other HFAs who have had success with the program.** Agencies in Georgia, Missouri and Massachusetts have state housing tax credits programs that have stood the test of time and are widely viewed as successful.

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CONSIDERATIONS FOR STATE HOUSING CREDIT PROGRAMS

When designing a state affordable housing tax credit program, state legislators and HFAs have key decisions to make to tailor the program to their state's political and economic context.

Allocated vs. Certificated. Allocated credits are credits that are generated as a result of an equity contribution to a project. Certificated credits are purchased from a project, or one of its participants.

Allocated credit considerations

- Often, allocated credits are earned over multiple years. It is important for tax reasons for project investors to have entrepreneurial risk, and the duration of the credit period is one factor to help establish that risk. The delayed impact to the state revenues also allows programs to be larger than if funded over one year (like a bond), though this longer period will result in discounted equity pricing equal to the time value of money.
- Allocated credit equity is generally regarded as nontaxable. So long as partners are deemed to make capital contributions to project partnerships (and not purchases of credits from developments), the money received will not be taxable, and thus will not negatively impact federal Housing Credit pricing.
- Allocated credits may result in a loss of federal tax deductions. It will be important for investors to work with experienced tax professionals in claiming the credits.
- Allocated credits often require compliance for longer periods of time (e.g. 15 years). In the event of noncompliance, credits can be recaptured from the allocatee or disallowed if not yet claimed.

Certificated credit considerations

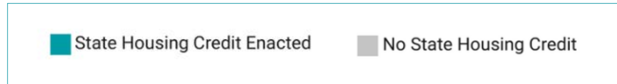
- Certificated credits are often issued one year at a time, or for a shorter duration than the federal Housing Credit. This results in less of an up-front pricing discount for state, due to a more immediate fiscal impact when redeemed.
- Certificated credits are often transferable to multiple investors increasing flexibility for the investor base as no ownership interest is required to claim the credit. This drives up investor demand and thus pricing. Though, because no ownership is required and credits are freely assignable, it is difficult to enforce recapture with a certificated credit.
- The sale price received for certificated credits is taxable income. To minimize tax consequences, certificated credits are sometimes issued to nonprofits, who loan the proceeds into the housing transaction. Such loans must qualify as "true debt" or the project will need to reduce its eligible basis, thus reducing federal credits. It is important to work with experienced tax professionals on structuring these types of transactions.

Duration. See the notes on allocated vs certificated credits above. Many state credit programs follow the federal Housing Credit 10-year credit period and 15-year compliance period. Others have shorter periods, often 6 years. Allocated credits generally have credit periods of 5 years or longer, as anything shorter is likely to be found to be a sale for federal income tax purposes. The 5 – 10 year window is recommended, but states should take into account local market conditions and investor appetite.

Pricing. Investors price credits based on yield (aka investor return) expectations, similarly to the federal Housing Credit. Longer credit periods do not necessarily result in higher yield expectations, but the equity pricing per dollar of credit will be lower due to the time value of money. Higher equity pricing as a result of a shorter credit period does not necessarily result in more efficient use of tax dollars that fund the program. While a shorter credit period may yield higher equity pricing, investors will need to be able to redeem the credits faster, costing the state more money in the shorter term than if the cost was spread out over a longer term.

Refundability. The US Tax Court has held that potentially refundable credits create income upon receipt. Due to the tax complexities involved in federal Housing Credit projects, most programs avoid refundable credits.

STATE HOUSING CREDIT ANNUAL FUNDING AUTHORIZATION (2023)



WA
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NV 20-40 MM
UT ≈100MM
CO 60MM
CA 646MM
KS 85MM
MO 135MM
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IN 30MM
OH 100MM
PA 50MM
NY 150MM
VT 3.5MM
NH
ME 10MM
MA 200MM
RI 30MM
CT 100MM
NJ 100MM
DE
MD
DC ≈7.4MM
WV
VA 60MM
KY
NC
TN
SC 200MM
AZ 40MM
NM 4-5MM
OK 8MM
AR 250M
MS
AL
GA 600-800MM
LA
TX 2.5MM
FL
AK
HI 125MM

The authorization amounts included in the above map are based on the interpretation of state legislation by experts in the AHTCC's State Tax Credit Working Group and may include approximations. These amounts provide an indication of the amount of state credit resources available annually as of September 2023, but may vary based on state housing tax credit program structure and fluctuations in annual allocations of non-capped state housing tax credits.

STATE CREDIT RESOURCES

(Source: Novogradac & Co)

Overview of state Housing Credit programs
State Housing Credit program descriptions

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