NATIONAL HOUSING LAW PROJECT

Low-Income Housing Tax Credit (LIHTC) Overview
May 2020

The National Housing Law Project has created this outline to provide reference materials for advocates serving clients in finding and maintaining safe, decent, and affordable housing. This outline provides an overview of the Low-Income Housing Tax Credit Program.

Key Components

- **Number of Units**: about 3.05 Million, growing at about 108,000 annually.
- **How Program Works:**
    - ***Subsidy Mechanism***: Each state gets a certain number of tax credits based on its population. The state agencies, usually called housing finance agencies ("HFA) administer the program. Each state HFA creates a Qualified Allocation Plan (QAP), which sets out priorities for allocating tax credits to meet the state's affordable housing needs. Developers apply for those credits through a competitive process and the HFA awards them according to the QAP's priorities. The developers sell the credits to investors (who use the credits to reduce their own tax burden). This creates cash equity for the developer, reducing project development debt burden. In exchange for the tax credits, the property must rent a specific number of units to qualified tenants at specified rents, usually below-market. 26 U.S.C. § 42 (m).
    - ***Types of Credits***: Two types of tax credits are available: one at 9% which is usually competitively allocated (and provides about 70% of the project cost); the other, at 4% (which provides about 30% of the project cost), comes with state bond financing, which is capped and allocated by a housing finance agency, which may or may not be very competitive. 26 U.S.C. § 42 (b).

- **Ownership**: Usually limited partnerships, where investors/ corporations invest as limited partners, with corporate, nonprofit, or individual general partners; Properties are often later sold to general partner or others, often with new credits.

- **Use Restrictions**:
    - *Occupancy restrictions* (federal minimum): owner's choice of three 26 U.S.C. § 42 (g)(1):
        - (1)At least 20% of units occupied by tenants at no more than 50% of AMI
        - (2) 40% of units occupied by tenants at no more than 60% of AMI;
        - (3) As of 3/23/2018, new projects can also elect income averaging where some units can be designated up to 80% of the AMI as long as the average income limit of the LIHTC units in the property does not exceed 60% of the AMI. (note: many state HFAs have imposed additional requirements on properties that elect income averaging).
        - Note: many projects have 100% LIHTC units;

- *Rent restrictions* 26 U.S.C. § 42 (g) (2). Units have flat rents set at no more than 30% of income of tenants at the top of the selected AMI category, with an assumed family size of 1.5 persons per bedroom. For example, if a unit's rent restriction is 50% of the AMI, then the rent would be set at 30% of this amount. For properties developed between 1986 and 1989, these rent restrictions last only 15 years; post-1989 developments have at least 30 years. Because tax credits are competitively allocated, many states require even longer periods of rent restrictions. To find out how long your state requires for rent restrictions look at your housing finance agency's QAP or implementing regulations.

- **Who is Involved?**
  - The Internal Revenue Service (IRS) administers and monitors the LIHTC program on the federal level.
  - State housing finance agencies administer and monitor the program on the state level.
  - The owners of the property (usually a limited partnership). Management is either handled by the owners directly or a separate company.
  - HUD and/or a PHA may be involved if there are additional subsidies, such as Project-Based Vouchers or project-based section 8. Note: most RAD conversions of public housing properties involve tax credits.

- **Key Authorities**:
  - 26 U.S.C. § 42 (Internal Revenue Code).
  - Treasury regulations at 26 C.F.R. §1.42.
  - IRS Guide, Guide for Completing Form 8823 Low-Income Housing Credit Agencies Report of Noncompliance or Building Disposition. ("8823 Guide").
  - State QAP.
  - State LIHTC regulations.

- **Finding Out if a Property is LIHTC:**
  - <u>HUD LIHTC Database</u> available at: https://lihtc.huduser.gov/
  - <u>The Preservation Database</u> available at: https://nhpd.preservationdatabase.org
  - The property will have a recorded regulatory agreement which would be filed with the City or County the property is located in.
  - Other factors that may indicate a property is LIHTC: the tenant's lease; the tenant's rent level; owner type; age of housing (LIHTC properties were all built after 1986).

Major Applicant and Tenant Issues

- **Admissions**:
  - <u>Income Eligibility</u>: At the time of the initial income certification, the tenant household must earn an income at or below the AMI designation of the unit.

        - Although not a HUD program, income for LIHTC tenants uses the same rules and regulations as the HUD Multifamily Programs. *See Occupancy Requirements of Subsidized Multifamily Housing Programs (4350.3*), U.S. Department of Housing and Urban Development).
    - Vouchers: LIHTC owners may not refuse to rent to section 8 voucher holders because of their status, presumably at least so long as the rents are determined reasonable by the PHA. 26 U.S.C. § 42(h)(6)(B)(iv) and 26 C.F.R. § 1.42-5(c)(1)(xi)).
    - Students: Special eligibility rules apply for students but they lack clarity. Neither the Internal Revenue Code nor its implementing regulations state that the presence of students disqualifies a unit from complying with the Code's low-income occupancy requirements. Instead, the code identifies five exceptions that will not disqualify a unit from being considered low-income. 26 U.S.C. § 42 (i)(3)(D).
    - Immigration Status: the Internal Revenue Code (IRS) does not include any requirements that tenants in LIHTC properties show documentation of or be citizens or lawful permanent residents of the United States. However, there is no statutory authority affirmatively granting undocumented tenants the right to live in LIHTC properties. The IRS has also declined to issue any guidance regarding immigration status and eligibility.
    - Fair Housing: The Fair Housing Act prohibits discrimination on the basis of a person's membership in a protected class (including race, color, national origin, religion, sex, familial status, or handicap) with regards to the sale or rental of housing. 42 U.S.C. §3604.

- **Rents**
    - LIHTC rents are not based on a tenant's income. Instead, rent is set by the use restriction tied to the unit. This means that a tenant's rent will not change even if their income significantly increases or decreases. A tenant cannot pay more than this set maximum rent. LIHTC rents are set at 30% of the AMI (area median income) category tied to the unit. For example, if a unit's rent restriction is 50% of the AMI, then the rent would be set at 30% of this amount. 26 U.S.C. § 42(g)(2).
    - After initial certification, if a tenant's income increases above the AMI amount tied to the unit they are still eligible to remain in the unit. This is inferred from the next available unit rule.
        - Next Available Unit Rule: If a household's income rises above 140% of the income limit associated with the unit, the household will still qualify to remain in the unit at the current rent. However, the property must offer the "next available unit" to an income-qualifying tenant. This rule only applies to properties that are mixed-income. *See* 8823 Guide Pg. 14-1.
    - Some tenants in LIHTC may have Vouchers (Project-Based or Housing Choice), with their contributions determined under Voucher program, and total rent may

exceed LIHTC limits, if market-reasonable, up to local payment standard. 26 U.S.C. § 42(g)(2)(B)(1).
  - Recertification: Once annually. Buildings that are 100% LIHTC do not have to do annual recertifications. See 8823 Guide Pg. 5-2.
  - Utility Allowance: flat rents are gross rents, and where utilities are tenant-paid, tenant must receive a utility allowance. Owners have discretion to use several different sources of data to establish allowances, including the local PHA's utility allowance. 26 C.F.R. § 1.42-10(b)(4)(ii).
  - Rent Increases: Because rent amounts are tied to the AMI of the area where a tenant lives, rents in LIHTC properties may change from year to year. The amount for households in each area of the country, is calculated on a yearly basis and is published by HUD. LIHTC properties are permitted, but not required to increase rents based on these amounts

- **Grievance Procedures:** The LIHTC program does not require a grievance procedure or administrative review by statute or regulation. However, a state HFA could create a requirement through the QAP process and/or the property's regulatory agreement could require one. Note: if a building has other subsidies a grievance procedure may be required.

- **Evictions and Terminations**
  - Notice: There is no federal statutory or regulatory requirements regarding length or content. State rules or policies may require certain notice.
  - A property must have good cause required to evict a tenant during and after the end of a lease term. SIRS Revenue Ruling 2004-82 ("Revenue Ruling")(July 30, 2004) (statutory interpretation). As of 12/31/04, all LIHTC use agreements must contain a prohibition against eviction absent good cause. Revenue Ruling 2004-82. Additionally, some Housing finance agencies require additional notice to the tenant of good cause protections-such as a lease provision or rider.
  - *See also, e.g., Carter v. Maryland Mgmt. Co.,* 2003 WL 22533198, 2003 Md. LEXIS 740 (Md. Ct. App. Nov. 10, 2003) (good cause required for termination of LIHTC/Voucher tenancy, but good cause found); *Cimarron Village Townhomes, Ltd. v. Washington*, 1999 WL 538110, 1999 Minn App LEXIS 890 (Minn. App. 1999) (good cause eviction protection required under LIHTC statute), 659 N.W.2d 811 (Minn. App. 2003) (finding good cause); *Bowling Green Manor v. LaChance*, 1995 Ohio App. LEXIS 2767 (because eviction of Section 8 Voucher tenant from LIHTC unit constituted state action, owner could therefore not refuse to renew lease absent good cause); Mendoza v. Frenchman Hill Apts., No. CS-03-0494-RHW (E.D. WA order Jan. 20, 2005) (finding § 1983 claim unavailable to challenge HFA's and owner's failure to include required prohibition on no-cause evictions in regulatory agreement).
  - <u>Good cause required for non-renewal of the lease</u>: *V.I. Cmty. Hous. Ltd. P'ship v. Rivera 2008 WL 5411985* (V.I. Super. Ct. Dec. 24, 2008) (tenant presented a

colorable claim that under the LIHTC regulations, good cause is required to evict upon expiration of her lease). In contrast, some housing finance agencies interpret this differently and have determined that good cause is not required for non-renewals.

- **Current Issues:**
  - Expiring Uses: Starting in 2020, the 30 year use restrictions for many LIHTC units will begin to expire, placing a significant portion of the country's affordable housing stock at risk. By 2030, the number of impacted units is expected to reach 500,000. Some of these units will be converted to market rate housing or will have deteriorated to a point where they will be in need of significant reinvestment of rehabilitation. *See National Low-income Housing Coalition, Balancing Priorities: Preservation and Neighborhood Opportunity in the Low-Income Housing Tax Credit Program Beyond Year 30* (2018)

  - Qualified Contracts The IRS code allows for properties to get out of the affordability use restrictions early by the use of the qualified contract process. If the project owner gives written notice to a state housing finance agency of a desire to sell the property, and the housing credit agency is unable within one year thereafter to present a "qualified contract" for a buyer to continue to operating the property under the LIHTC program. 26 § U.S.C. 42(h)(6)(F). Many state housing finance agencies require (or award additional application points) to projects that waive the right to a qualified contract. However, this is a relatively new trend and a significant number of use agreements without a waiver of qualified contract rights still exist.

  - Planned Foreclosures The IRS code also allows for properties to be released early from use restrictions in the event the property is foreclosed on. 26 § U.S.C. 42(h)(6)(E). Advocates across the country have begun to notice a trend where properties will take actions to intentionally set a property up for a foreclosure in order to be pre-maturely released from affordability use restrictions.

  - Properties released from use restrictions in violation of the Internal Revenue Code: Although the IRS code only allows for early release due to qualified contracts of foreclosures, advocates have documented numerous examples of housing finance agencies allowing properties to be released from use restrictions for other reasons.

  - Segregation of LIHTC Properties: In the 2015 *Inclusive Communities Project v. Texas Dep't of HCA* case, the Plaintiffs argued that the disproportionate placement of LIHTC properties in Texas low-income communities of color violated the fair housing act. *Inclusive Communities Project v. Texas Dep't of HCA* 135 S. Ct. 2507 (2015). In response to this case, many housing finance

agencies across the country have begun looking at the segregation of their properties and have begun undertaking efforts to site future properties in areas of higher-opportunity. This has highlighted the need for advocates to engage with housing finance agencies ensure that LIHTC tenants are given true housing choice to live in high opportunity areas while continuing to bring resources to areas that have suffered a historical lack of disinvestment.

- Nonprofit right of first refusal: The IRS code contains a provision that allows for the inexpensive transfer of ownership interests from investors to nonprofits after all of the tax credits have been allocated. *See* 42 U.S.C. § 1437. This is an important provision in the code as nonprofits are more likely to keep properties affordable after use restrictions expire. Some investors have begun refusing to make these transfers in an effort to keep ownership interests so properties can be sold at a higher profit, placing the preservation of affordable units in jeopardy.