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Santa Brought a 4% Present for Desperately Needed Affordable Housing

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On December 27th, President Trump signed the Consolidated Appropriations Act, 2021. The 2,124 pages of legislation was most widely known as containing stimulus provisions related to the COVID-19 crisis but also addressed many other issues. Included in the legislation was a small provision that will significantly increase the amount of affordable housing built using the Low-Income Housing Tax Credit ("LIHTC" or "Credits"). This provision permanently fixed a minimum credit rate of 4% on tax-exempt financed projects and acquisition credit projects that satisfy the new statutory requirements. This provision had long been advocated for by industry groups that Applegate & Thorne-Thomsen actively participates in. Importantly, it has been estimated by Novogradac & Co. that the extra equity created by the new 4% minimum credit rate could result in up to an additional 126,000 units from 2020-2029.

What Does a 4% Floor Mean?

- **Actual 4% Minimum Rate for buildings placed in service after December 31, 2020.** The 4% rate will be used rather than the lower monthly floating rate.
- **Applies to Tax-Exempt Financing Projects**.
- **Applies to Acquisition Credits on Allocated Project**
- **Net Result - Maximum Credit Amount Increased** – Potential Credit amount increase is nearly 30% for tax-exempt financed projects. Allocated projects with acquisition credits would support almost 30% more acquisition credit, subject to receipt of sufficient Credits from the state credit agency.

Proposed projects with Credits based on either tax-exempt financing or acquisition credits (assuming the existing building was not acquired and placed in service before 2021) should now use the 4% minimum rate when applying to state credit agencies and tax-exempt financing issuers ("Issuer") consistent with guidance issued by such agencies.

HOW DOES THE 4% FLOOR HELP AFFORDABLE HOUSING?

The new 4% floor on the credit rate is a significant benefit for affordable housing. Many tax-exempt financed projects or acquisition credit projects which had unfilled financing gaps may now be feasible. Projects may require less soft financing allowing governmental and nonprofit soft lenders to redeploy funds to other projects and thus make more projects feasible. Projects with significant deferred developer fee may be able to pay more of that developer fee upfront and defer

less fee. Overall, more housing may be built and many projects may be less financially stressed than they otherwise would have been. While the legislation provided a down payment on badly needed COVID-19 relief, it has also taken a meaningful step forward for a country with a severe shortage in affordable housing.

My Project Issued Bonds in 2020 or Got a Carryover in 2020, Does It Qualify?

Probably not. In order to get the 4% minimum rate, one of the following effective date provisions must apply:

- **Bonds Must Be Issued After December 31, 2020**, or
- **Carryover Must Be Issued After December 31, 2020**

Draw-Down Bonds Answer Unclear – A question quickly arose among industry practitioners as to whether draw-down bonds with draws after 2020 qualify for the new credit rate. In draw-down bonds, the federal volume cap on the entire issue is used when an initial draw of at least $50,001 is made and the financing is deemed issued. When draw requests are made for future amounts, the bond holder loans the needed funds at that time and interest then begins to accrue. For purposes other than volume cap, there is authority that provides that the funding of that draw by the bond lender constitutes the bond "issuance". There is therefore a reasonable argument that the draws made in 2021 or later would constitute an issuance after December 31, 2020, thus qualifying such a project under the statutory language for the minimum 4% rate. However, there are also counterarguments to that position. We have heard that the intent of some of the Congressional Committee members was for the 4% minimum rate not to be retroactive. Investors may be unlikely to invest additional equity in such situations until the Joint Committee on Taxation issues a report (called a "Blue Book") or until the IRS provides guidance.

Additional Bond Issuance Might Work – Another question that has been raised is whether a project could qualify if it had issued pre-2021 tax-exempt bonds but ran into a cost overrun or had other reasons necessitating an additional loan of tax-exempt funds and then had a supplemental new bond issuance after December 31, 2020. While there is a pretty good statutory argument that such a project should qualify since there are bonds clearly issued after December 31, 2020, this does run contrary to what we are told was the general Congressional intent to avoid retroactivity. This is likely another area where a Blue Book or IRS guidance will guide the industry.

My Project has a 2021 Bond Issuance/Reservation for 2021 Credits, Are the Extra Credits Automatic? Someone Said Something About Financial Feasibility?

Receiving the additional Credits is not automatic. Section 42 has always limited the amount of LIHTC a project receives to the amount that the state credit agency or bond Issuer determines is needed for **financial feasibility**. This would be especially important for projects that are already underwritten at the old floating credit rates but will close in 2021 and meet the above discussed requirements for the new 4% floor on the credit rate. The extra Credits must be needed for the

project's financial feasibility in order for the state credit agency or bond Issuer to allow it. The issue then becomes, where does all the extra equity generated by the additional Credits go?

- Perm Loan Reduction – Unfortunately one can't simply reduce the amount of a permanent commercial loan and make the project more profitable. A project should have the kind of loan that underwriting shows it can support.
    - Scope Increase – A permanent loan amount could stay the same if project costs increase by adding back project scope that had previously been cut in order to make the project's sources and uses match. In this way, the extra equity is paying for the added scope.
    - Rent Reduction – A permanent interest-bearing loan could be reduced if rents are also lowered to allow units to be affordable to lower-income tenants. In such cases, the lower debt payments would be needed to offset the rent reductions.
- Soft Debt – There will need to be a discussion with soft lenders and the state credit agency/Issuer about how the extra equity is used. The soft lenders may want their loans reduced or eliminated so that those funds can be redeployed to other projects (a huge win for more affordable housing!). It is also possible that keeping those loans may be required for application scoring or other purposes. As discussed above, it might be possible to keep the soft debt unchanged if the construction scope is increased and approved by all parties.
- Deferred Developer Fee – Most projects have deferred developer fee that could be paid and use up much or all of the equity increase. With respect to deferred developer fee, it will be important to see how much the state credit agency will allow it to be paid down, as some credit agencies or soft lenders require a minimum deferred developer fee.

How to Document a Restructuring with the 4% Credit Floor

For Bond Projects – Any proposed restructuring should result in an update to the 42(m)(2)(D) letter issued by the Issuer (and receipt of agreement of soft lenders). The 42(m) (2)(D) letter is the determination by the Issuer of the amount of LIHTC needed for financial feasibility. In projects where the Issuer is not the same entity as the state credit agency, Issuers will often rely on the determination by the state credit agency of the amount of credits needed for financial feasibility. Getting an updated 42(m)(2)(D) letter will generally require communicating with both the state credit agency and Issuer and updating applications for tax credit and tax-exempt financing.

For 2021 or Later Carryovers (Remember 2020 Carryovers Don't Get the 4% Floor) – The 4% floor on the credit rate means the project could support more acquisition credits than previously anticipated when applications were submitted or reservations were issued. If the project was already getting the maximum amount of Credits supported by its eligible basis, then it is possible the state could allocate more Credits to the project since the acquisition could now generate more LIHTC. A state credit agency might like to do this in order to reduce the soft funding commitments to a project. Any extra equity would need to be accounted for in an updated application or other correspondence and approved by the state credit agency.

Caution on Credit Pricing: If a Project Delivers Almost 30% More LIHTC, Equity May Not Go Up the Same Amount

Extra Credits from the 4% rate can result in almost a 30% increase in investor equity as compared to the current floating credit rate of 3.09% for tax-exempt financed projects. However, the extra Credits are not likely to generate the same amount of equity on a dollar per Credit basis, because an investor's return is based on a combination of tax credits and tax-deductible losses. The losses are primarily generated from depreciation and interest expense. If the Credit amount goes up but depreciation stays the same (assuming the project cost hasn't changed), then the extra Credits are providing less yield. As a result, the price per Credit would need to go down to maintain the investor's required yield. In addition, to the extent that extra equity reduces the amount of hard or soft interest-bearing debt, that would also reduce interest deductions to the investor and the investor's yield. The extra Credits will still provide a strong benefit to the Project by allowing lower debt on the project, but it likely will not be at the same dollar per Credit amount that was originally used.

Thank Your Congressional Legislators

The new 4% Credit rate floor is a significant benefit for affordable housing. Please thank your Congressional legislators for this important change to help produce more affordable housing.

Additional Information

For additional information please contact the Tax Group at Applegate & Thorne-Thomsen or any of your contacts at the firm.

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