



HMFA

NEW JERSEY HOUSING AND MORTGAGE FINANCE AGENCY



LOW INCOME HOUSING TAX CREDIT PROGRAM OVERVIEW

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TAX CREDIT OVERVIEW

- The credit is a 10-year tax incentive to encourage the development of residential rental housing at or below 80 percent of area median income (AMI).
- Credits are awarded to a developer (general partner) based on the cost of construction. The credits are typically then sold or “syndicated” to an investor limited partner (typically CRA-driven banks, large corporations or an equity fund).
- The equity generated from the sale of 9 percent credits can fund approximately 70 percent of the total development costs of the project or approximately 30 percent of the total development costs for 4 percent credits. The reduced funding gap allows the project to carry a smaller mortgage; therefore, the project can charge lower, more affordable rents.
- There are two types of tax credits:
 - 9 percent credits are available to projects with conventional/taxable financing. New Jersey’s authority for 9 percent credit is temporarily increased to \$2.70 per capita for the years 2018-2021.
 - Projects that receive tax exempt bond financing are limited to a 4 percent credit. The availability of 4 percent credits is based on the availability of bond financing from the State’s volume cap.

NJHMFA’S ROLE

- NJHMFA is the housing credit agency responsible for administration of the federal Low Income Housing Tax Credit Program in New Jersey.
- NJHMFA allocates over \$20 million in 9 percent credits annually, which generates approximately \$190 million in equity for the development of affordable housing in the state.
- With demand for 9 percent credits exceeding supply by approximately 3:1, NJHMFA has instituted a competitive awards process in its Qualified Allocation Plan (QAP).
- NJHMFA is also charged with monitoring the long-term compliance of these projects with Section 42 of the Internal Revenue Code. There are over 600 projects statewide that contain over 50,000 tax credit units in NJHMFA’s portfolio.

LOW INCOME HOUSING TAX CREDIT (LIHTC) BASICS

The LIHTC Program is an indirect federal subsidy used to finance the development of affordable rental housing for low- and moderate-income households. The LIHTC program may seem complicated, but many local housing authority and community development agencies are effectively using these tax credits to increase the supply of affordable housing in their communities. This topic outline is designed to provide a basic introduction to the LIHTC program.

HOW DO HOUSING TAX CREDITS WORK?

The LIHTC program, which is governed by Section 42 of the Internal Revenue Code, was enacted by Congress in 1986 to provide the private market with an incentive to invest in affordable rental housing. Federal housing tax credits are awarded to developers of qualified projects. Developers then sell these credits to investors to raise capital (or equity) for their projects, which reduces the debt that the developer would otherwise have to borrow. Because the debt is lower, a tax credit property can in turn offer lower, more affordable rents.

Provided the property maintains compliance with the program requirements, investors receive dollar-for-dollar credit against their federal tax liability each year over a period of 10 years. The amount of the annual credit is based on the cost to construct or rehabilitate the affordable housing:

Credits: Tax credits are subtracted directly from one's tax liability. Credits reduce tax liability dollar-for-dollar.	Deductions: Tax deductions are subtracted from a taxpayer's total income to compute his or her tax base. Deductions reduce tax liability by the amount of the deductions times the tax rate.
For example: A \$1,000 credit in a 15 percent tax bracket reduces tax liability by \$1,000.	For example: A \$1,000 deduction in the 15 percent tax bracket reduces taxable income by \$1,000, thereby reducing tax liability by \$150.

ALLOCATING HOUSING TAX CREDITS

Each year, the IRS allocates housing tax credits to designated state agencies – typically state housing finance agencies – which in turn award the credits to developers of qualified projects. Each state is limited to a total annual housing tax credit allocation per resident, which is adjusted annually for inflation.

States allocate housing tax credits through standards and procedures outlined in its Qualified Allocation Plan (QAP). Federal law requires that the allocation plan give priority to projects that (a) serve the lowest income families; and (b) are structured to remain affordable for the longest period of time. Federal law also requires that 10 percent of each state's annual housing tax credit allocation be set aside for projects owned by nonprofit organizations. For additional information, please see the Agency's QAP.

A state has two years to award housing tax credits to projects. Tax credits not awarded in a year may be carried forward to the next year. If a state is unable to use its tax credits over a two-year period, they are returned to a national pool for re-allocation. If a state awards tax credits to a project that is not completed and the tax credits are returned, the state has an additional two years to award the tax credits to another project within that state.

ELIGIBILITY

To be eligible for consideration under the LIHTC program, a proposed project must:

- Be a residential rental property
- Commit to one of three possible low income occupancy threshold requirements
- Restrict rents, including utility charges, in low-income units
- Operate under the rents and income restrictions for at least 15 years, pursuant to written agreements with the agency issuing the tax credits

RESIDENTIAL RENTAL PROPERTY

The LIHTC program is available for new construction, or requires that rehabilitation be performed if the developer is acquiring an existing building. Tax credits may also be earned on the acquisition of an existing development provided the owner meets the 10-year previous ownership rule. This rule states that the property to be acquired must not have changed ownership and been placed in service during a 10-year period prior to acquisition. A building that has not been used in 10 or more years can claim the acquisition credit even if its ownership has changed, given that it has not been placed in service during that period. The 10-year rule does not apply to projects that are substantially assisted, financed or operated by the U.S. Department of Housing and Urban Development (HUD).

OCCUPANCY THRESHOLD REQUIREMENTS

Projects eligible for housing tax credits must meet low-income occupancy threshold requirements. Project owners may elect one of the following two thresholds:

- **20-50 Election:** At least 20 percent of the units must be rent restricted and occupied by households with incomes at or below 50 percent of the HUD-determined area median income (adjusted for household size).
- **40-60 Election:** At least 40 percent of the units must be rent restricted and occupied by households with incomes at or below 60 percent of the HUD-determined area median income (adjusted for household size).
- **Income Averaging Election:** The income designations of at least 40 percent of the units in a housing project average 60 percent or less of the HUD-determined area median income (adjusted for household size).

Typically, state QAPs encourage applicants to provide more than the minimum number of affordable units, and to provide greater than the minimum level of affordability. Moreover, credits are available only for the affordable units. As a result, many applications provide for 100 percent of the units to be affordable, and many applications provide for some units to be affordable well below 50 percent of AMI.

RENT LIMITS

The rent for each unit is established so that tenant monthly housing costs, including a utility allowance, do not exceed the applicable LIHTC rent limit. These limits are based on a percentage of AMI, as adjusted by unit size. Of course, rents cannot exceed local market rents.

It is important to note that the LIHTC program restricts only the portion of the rent paid by the tenant, not the total rent. As a result, certain rental assistance programs (rental subsidies) can be used to raise the total rent above the LIHTC rent limit, as long as the tenant portion of the rent does not exceed the maximum allowed.

AFFORDABILITY REQUIREMENTS

The LIHTC Program requires a minimum affordability period of 30 years (i.e., a 15-year compliance period and subsequent 15-year extended use period). Some states require a longer affordability period for all LIHTC properties, and other states may negotiate longer affordability periods on a property-specific basis. Tenant incomes are recertified annually to ensure their continued eligibility. The Agency is responsible for monitoring compliance with the provisions during the affordability period and must report the results of monitoring to the IRS.

SYNDICATION

Developers may claim housing tax credits directly, but most sell the tax credits to raise equity capital for their housing project. The developer can sell the tax credits:

- Directly to an investor, or
- To a syndicator, who assembles a group of investors and acts as their representative.

Tax credits can be claimed annually over a 10-year period by the property owner. However, the developer needs the money immediately to pay for development costs, not 10 percent annually for 10 years. Accordingly, the developer typically syndicates the credits – i.e., sells the rights to future credits in exchange for upfront cash.

The credit purchaser must be part of the property ownership entity; usually, this is accomplished by creating a limited partnership (in which the credit purchaser is a 99 percent+ limited partner) or a limited liability company (in which the credit purchaser is a 99 percent+ non-managing member). The general partner is responsible for managing the project and the partnership, while the limited partners are typically limited to a passive investment role. Typically, profits and losses and housing tax credits are shared according to the partners' (members') percentage ownership interest. However, each Limited Partnership Agreement (or LLC Operating Agreement) also provides for a carefully negotiated “waterfall” that describes how any positive cash flow of the property is to be distributed. Typically, the general partner (managing member) receives a large share of any positive cash flow, often structured in the form of fees for services such as partnership management, incentive management or investor services.

- A typical LIHTC LLC consists of the developer (or an affiliate) as the managing member, and the credit purchaser as an additional (non-managing) member. The managing member has a small percentage ownership interest (often .01 percent), but has the responsibility to manage the affairs of the partnership, arrange for the management of the property, and make most of the day-to-day operating decisions. The non-managing member has a large percentage ownership interest (often 99.99 percent), and has a passive investor role. All members of an LLC have liability that is limited to the amount invested. That is, in the event of a catastrophic financial loss, the most they can lose is the amount invested. The rights and obligations of the partners are described in an LLC Operating Agreement. Typically, the non-managing members do not participate in day-to-day operating decisions but do participate in major decisions such as decisions to sell or refinance the property.

A CLOSER LOOK AT SYNDICATION

Syndication is a complex and expensive process. By law, syndicators must offer prospectuses to potential tax credit purchasers, fully disclosing the terms and risks of the investment. Sales of tax credits to multiple investors in the general public are referred to as public placements and have the highest disclosure requirements. Private placements are sales to a few knowledgeable investors. They have lower disclosure requirements and sales costs.

Of course, developers are interested in the highest possible price paid by investors, and the lowest possible syndication costs. Similarly, investors are interested in paying the lowest possible price, at the lowest possible level of risk. Syndicators are interested in earning high fees and potentially future business with the developer and investors. To-be-developed properties are not easy to evaluate. These factors mean that the market for housing tax credits is as complicated and sophisticated as the market for stocks and bonds. It is also quite competitive.