

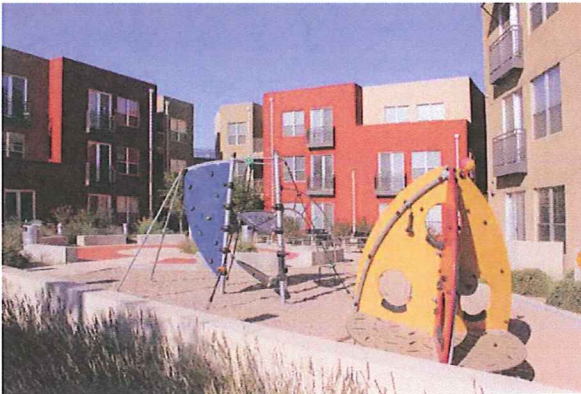


Supporting Permanently Affordable Housing in the Low-Income Housing Tax Credit Program: An Analysis of State Qualified Allocation Plans



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Sawmill Community Land Trust LIHTC projects, Albuquerque, NM | **Top left:** Villa Nueva Senior Apartments, a 46-unit project affordable to residents 55+ earning <50% of AMI. **Bottom Left:** Sawmill Lofts, 60 units Live/Work spaces for individuals and families earning <60% AMI. **Right:** The Artisan at Sawmill Village, 60 units affordable to residents <50% AMI.

Abstract

The Low Income Housing Tax Credit (LIHTC) program is the country's largest source of federal subsidy for affordable housing. Since its inception, the program has financed more than 2.2 million housing units, accounting for about one-sixth of all rental housing in the country.¹ Limited affordability periods, and the ability for property owners to "opt out" of the program after 15 years, have raised concerns about the loss of affordable units to market rate conversion, particularly in strong housing markets. Organizations that provide permanently affordable housing, often referred to as "shared equity" models, can ensure the affordability and stewardship of LIHTC housing in perpetuity and preserve public subsidies. In turn, the LIHTC program can more effectively utilize public dollars by funding the permanently affordable housing sector. Based on a review of Qualified Allocation Plans (QAPs) for all fifty states and Washington DC, this report identifies policies and preferences states have adopted to guide the allocation of LIHTC resources that can support permanently affordable housing.

¹ Khadduri, Jill, Climaco, Carissa, Burnett, Kimberly, Gould, Laurie and Elving, Louise. 2012, August. What Happens to Low-Income Housing Tax Credit Properties at Year 15 and Beyond? US Department of Housing and Urban Development, Office of Policy and Development Research. Retrieved August 7, 2012: http://www.huduser.org/portal/publications/hsgfin/lihtc_report2012.html.

What is Permanently Affordable Housing?

Permanently affordable housing (PAH) is housing that is affordable to low- and moderate-income households now and in the future. The PAH sector includes both permanently affordable rental units and shared equity homeownership units. Shared equity homeownership models—including community land trusts (CLTs), limited equity cooperatives and long-term deed-restricted housing programs—restrict the price for which a home is sold to the first lower income buyer and every subsequent lower income buyer to preserve affordability in perpetuity. Ultimately, these homeowners and the stewarding organization agree to share the rights, responsibilities, risks, and rewards of homeownership. In this report, non-profit and government organizations with shared equity homeownership programs are referred to as “PAH organizations.”

PAH organizations are committed to providing a continuum of housing options for low-income households. They have an expertise in helping households attain and retain homeownership and, in the process, build the kind of transformational wealth that changes lives. On the rental side, PAH organizations have provided low-income households with high-quality and affordable housing that allows them to realize residential stability and financial security. The PAH sector is able to achieve these results by equally emphasizing resident support services and quality housing design, construction, and management. The stewardship of homes and residents provided by PAH organizations ensures that: 1) high-quality, well-maintained affordable housing benefits communities, and 2) lower income households realize positive outcomes from their tenure.

What is the Low Income Housing Tax Credit?

Established by the Tax Reform Act of 1986, the Low Income Housing Tax Credit (LIHTC) program provides market incentives for the development or rehabilitation of rental housing affordable to households with incomes equal to or less than 60 percent of area median income (AMI). In its more than 25 year history, LIHTC has become the largest program in the United States for affordable rental housing

production, having helped fund the development of more than 2.2 million housing units.²

The federal government annually issues tax credits to state housing finance agencies (HFAs) on a per-capita basis. State HFAs allocate credits through a competitive process in accordance with their housing priorities articulated by their Qualified Allocation Plans (QAP), the principle document used to determine which housing developments receive tax credits during a given allocation period.³ Developers sell tax credits to investors in exchange for equity; investors in turn get ten years of tax credits based on the total development cost.⁴ The developer, or general partner, is responsible for managing the project, while the credit purchaser typically assumes a passive investment role.

Properties financed with tax credits must remain affordable to low-income households for 15 years from the date they are placed in service (Figure 1). Projects that fall out of compliance with low-income occupancy requirements are subject to tax credit recapture. Despite changes to the LIHTC program in 1989 that extended the affordability period from 15 to 30 years, year 15 remains a critical juncture in the life of LIHTC projects. After the initial 15-year period, the obligation to report to the IRS on compliance issues ends. Hence, investors are no longer at risk of IRS penalties for failure to comply with program rules, and the HFA assumes sole responsibility for compliance monitoring.⁵ Additionally, an owner of a LIHTC property with a 30-year affordability restriction can opt out of the program in year 15 through the Qualified Contract (QC) process by requesting the HFA find a buyer committed to maintaining the property under the affordability restrictions.⁶ If no purchaser is found, affordability restrictions are phased out and the owner can reposition the units at market-rate.

² Ibid.

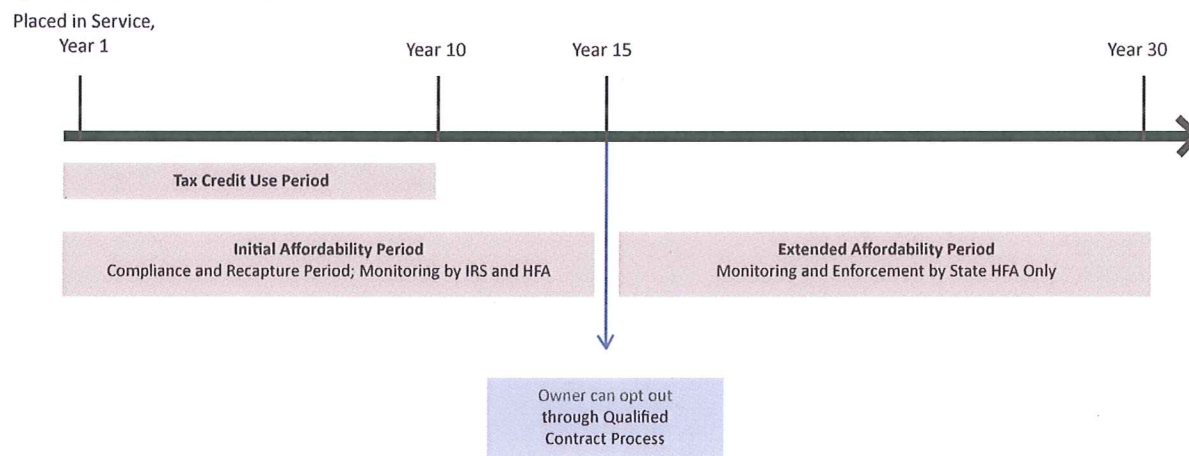
³ There are two types of LIHTCs—9% and 4% credits. Only the 9% credits, which generate more equity, are awarded on a competitive basis through the QAP. Four percent “as of right credits” are non-competitive and used in conjunction with bond financing.

⁴ The total amount of development cost eligible for generating LIHTC is the “eligible basis.” Eligible costs include all “hard” construction costs and most depreciable “soft” costs. Land and building acquisition costs are not included in the eligible basis. For more information on the eligible basis and calculating tax credits see Enterprise Community Partners Introduction to LIHTC available at: <http://www.enterprisecommunity.com/search-results?o-Search=eligible+basis>.

⁵ Ibid.

⁶ Transferring property to another owner will require additional costs. A nonprofit buyer will either have to secure additional grant funding or take on more debt, which can force up rents, reducing affordability and put the property at risk of default if the new debt is significant.

Figure 1: LIHTC Timeline



Using LIHTC resources on permanently affordable housing projects would increase the number of lower income households across generations served by the LIHTC program and concurrently retain the public's investment in affordable housing. Through LIHTC rental housing, the PAH sector can meet the needs of low-income households. At year 15, the PAH stewards would assess community needs and determine if LIHTC units should remain as permanently affordable rentals or be converted to permanently affordable owner-occupied housing using one of the shared equity homeownership models.

The LIHTC program can provide an important and substantial source of funding for the PAH sector, particularly since financing affordable housing has become more challenging during the economic recession. While some PAH organizations have effectively used LIHTC to increase the supply of permanently affordable housing in their communities,⁷ LIHTC deals are extremely complex. Smaller organizations often lack the capacity and technical expertise to put together project financing, undertake compliance reporting, and manage rental properties. Organizations without tax credit or rental management experience may build capacity through collaboration with an experienced tax credit project developer.

⁷ CLTs that have completed LIHTC projects include the Athens Land Trust, California Community Foundation Land Trust, Champlain Housing Trust, Irvine CLT, Mountainlands Community Housing Trust, NeighborWorks Blackstone River Valley, Sawmill Land Trust, Tenants to Homeowners, Inc., Thistle Communities, and Women's Community Revitalization Project.

Directing Tax Credit Allocations through the QAP

The Qualified Allocation Plan (QAP) is a policy tool that establishes the state's housing priorities and specifies the criteria used to select tax credit projects. State agencies "score" competing projects, awarding points to projects with characteristics outlined in the QAP.⁸ Because the supply of credits is limited, the allocation process is highly competitive under normal market conditions, and the QAP exerts strong influence on the character of LIHTC housing produced.

States typically use three mechanisms to guide the allocation of tax credits—threshold requirements, set-asides and point-based scoring criteria.

- *Threshold requirements* set minimum standards for LIHTC projects. Only developments meeting the threshold requirements are eligible to receive credits.
- *Set-asides* are funds from a state's tax credit allocation pool dedicated to specific types of projects.
- *Point-based scoring criteria* are used to rank qualifying development proposals based on state affordable housing priorities. HFAs award extra points to projects with desired characteristics.

⁸ Gustafson, Jeremy and Walker, Christopher. 2002, May. Analysis of State Qualified Allocation Plans for the Low-Income Housing Tax Credit Program. US Department of Housing and Urban Development, Office of Policy and Development Research. Retrieved March 5, 2012: http://www.huduser.org/portal/publications/hsgfin/analysis_of_sqa_plans.html.

The QAP is a state-wide document and must incorporate elements that encourage developers to meet the diverse housing needs of rural, suburban and urban areas. In this way, HFAs often include a number of requirements and selection criteria in their QAPs that may contradict or work against others. For instance, a QAP may award points to large multifamily projects consisting of at least 50 units and to projects that intend to convert to tenant ownership. However, homeownership conversions may only be permissible in developments consisting of single-family homes, duplexes and townhomes. In these cases, HFAs must balance competing criteria and developers must carefully consider their application as a whole in order to decide which points they want to pursue in order to be competitive.

Drawing on an analysis of the QAPs for all fifty states and Washington DC,⁹ this report identifies policies and preferences states have adopted to guide the allocation of LIHTC resources that may support PAH. Although no HFAs currently use LIHTC set-asides or points for PAH tax credit applicants, we focus on two categories of preferences that can favor the PAH sector: extended affordability periods and conversion to tenant ownership.

Incentivizing PAH through Extended Affordability

Extended periods of affordability required or incentivized by HFAs in their QAPs align well with the PAH sector's provision of affordability in perpetuity. Many states provide incentives or require developers

to commit to a 30-year extended affordability period, and a smaller number of states encourage or require developers to ensure affordability for more than 30 years. Because of their missions and track records, PAH organizations are uniquely positioned to increase the competitiveness of their LIHTC application by committing to extended affordability periods.

Thirteen states require LIHTC applications to extend affordability beyond the 15-year compliance period to be eligible to receive tax credits (Table 1). Almost twice as many states (24) incentivize extended affordability periods through the allocation of points. Nine states both require affordability restrictions beyond the 15-year compliance period and reward applications that go beyond the threshold requirement with points. Five states do none of the above. In these states, developers are still expected to satisfy the federal extended affordability period but the QAPs do not reinforce or strengthen this program requirement.

Of the 13 states that require extended affordability periods as part of their threshold requirements, 9 mandate that LIHTC applications commit to maintaining affordability for a minimum of 30 years (Table 2). The remaining 4 states require applications to exceed the federal minimum. While no state specifically requires extended affordability through PAH models, New Hampshire and Utah mandate LIHTC project affordability in perpetuity. New Hampshire allows for an opt-out in year 30 but the complex and onerous exit process discourages property owners from leaving the program.

Table 1: How States Incentivize Extended Affordability

Mechanism	# of States	% of States	States
Total	51	100%	
Threshold Requirements	13	25%	CA, ME, MD, MN, NH, NC, OH, OR, PA, RI, UT, VT, WI
Points	24	47%	AL, AK, AR, CO, CT, DC, DE, FL, GA, HI, IA, ID, IL, LA, MT, NE, NJ, NM, NY, OK, TN, TX, WV, WY
Threshold and Points	9	18%	KS, MA, MI, MS, NV, ND, SC, SD, WA
None	5	10%	AZ, IN, KY, MO, VA

⁹ We analyzed the most recent version of each QAP available. Depending on the state and their application timeline, the versions dated from 2011 to 2013.

Table 2: Length of Extended Affordability Thresholds by State

	# of States	% of States	States
Threshold Requirements	13	26%	CA, ME, MD, MN, NH, NC, OH, OR, PA, RI, UT, VT, WI
30 years	9	18%	ME, MN, NC, OH, OR, PA, RI, VT, WI
31-40 years	1	2%	MD
41-62 years	1	2%	CA
99+ years	2	4%	NH, UT

Table 3: Length of Extended Affordability Periods for States that use Thresholds and Points

	# of States	% of States	States
Threshold and Points	9	18%	KS, MA, MI, MS, NV, ND, SC, SD, WA
30 years	2	4%	KS, ND**
31-40 years	2	4%	SC, WA
41-62 years	4	8%	MI, MS, NV, SD
99+ years	1	2%	MA

**KS and ND offer points to incentivize that projects meet the 30-year threshold period.

Several states use a combination of threshold requirements and point incentives to encourage long-term affordability (Table 3). All of these states require that LIHTC applications meet a minimum threshold of 30 years of affordability and then provide points to incentivize an even longer-term commitment. Massachusetts, for example, requires that developers ensure affordability for 30 years and their QAP awards 3 points (or 1.6% of the total point allocation) for 50 additional years of affordability and 6 points (or 3.3% of the total points) for a guarantee of affordability in perpetuity.

The most popular way that HFAs extend project affordability beyond the 15-year compliance period is to exclusively offer point incentives with nearly half of states (47%) using this mechanism (Table 4). Four states offer points to applications that extend affordability for less than the federal minimum standard. While not ideal, this acknowledges that developers likely need incentives to meet program guidelines and not opt-out in year 15. Fifteen of the 24 states (29%) encourage longer affordability restrictions with the vast majority (11 states) incentivizing affordability for more than 40 years.

Point incentives vary by the length of affordability restrictions they encourage and by the weight they carry in the overall QAP application score (Table 5). Of the 33 states that offer point incentives (alone or in conjunction with threshold requirements) almost half (16) allocate only a small percentage of total points to projects that extend affordability periods. Given the extremely competitive nature of tax credit allocations, however, even small point incentives can make a difference.

As the PAH sector ensures affordability in perpetuity, these points offer a natural opportunity to increase application competitiveness. As described above, PAH organizations may increase their capacity and LIHTC competitiveness by partnering with an experienced tax credit project developer. Such a partnership, however, should be advantageous to both groups. A PAH organization's ability to satisfy extended affordability requirements or incentives makes them an attractive partner in a LIHTC project. Because PAH organizations produce high-quality housing that is built to last, however, they may be penalized for higher per unit construction costs. State HFAs should find ways to formally value high quality construction and permanent affordability as long-term investments that justify higher construction costs.

Table 4: Length of Extended Affordability Periods for States that use Only Points

	# of States	% of States	States
Total	24	47%	AL, AK, AR, CO, CT, DE, FL, GA, HI, IA, ID, IL, LA, MT, NE, NJ, NM, NY, OK, TN, TX, WV, WY
Less than 30 years	4	8%	AL, AR, GA, TN
30 years	5	10%	AK, DE, IA, NY, WV
31-40 years	4	8%	CO, LA, OK, TX
41-62 years	11	21%	CT, DC, HI, ID, IL, MT, NE, NJ, NM, WY, FL

Table 5: Strength of Point Incentives for Extended Affordability

Strength of Point Incentive	# of States	% of States	States
Total	33	100%	AL, AK, AR, CO, CT, DC, DE, FL, GA, HI, IA, ID, IL, KS, LA, MA, MI, MS, MT, ND, NE, NJ, NM, NV, NY, OK, SC, SD, TN, TX, WA, WV, WY
Strong (> 10% of total points)	7	21%	CO, HI, ID, NJ, NY, WA, WV
Moderate (5%-10% of total points)	10	30%	FL, IA, MT, NM, ND, OK, SC, SD, TN, WY
Weak (< 5% of total points)	16	49%	AL, AK, AR, CT, DC, DE, GA, IL, KS, LA, MA, MI, MS, NE, NV, TX

Conversion of LIHTC Rentals to Shared Equity Homeownership

Though generally thought of as a rental program, LIHTC rules allow for the conversion of rental units to tenant ownership, enabling states to use tax credits as a tool to promote homeownership. Although no HFAs expressly encourage conversion to shared equity homeownership, HFAs could promote the expansion of this homeownership model to ensure long-term affordability and retention of public funding. To encourage shared equity homeownership, LIHTC projects can be structured up-front as lease-purchase programs, whereby tenants may purchase their units with resale restrictions in year 15.¹⁰ While some housing advocates consider the 15-year lease-purchase tenancy period too long for most potential homebuyers, the Cleveland Housing Network (CHN), which operates one of the largest and most successful lease-purchase programs financed with LIHTC, has maintained a strong renter-to-owner conversion rate.¹¹

¹⁰ LIHTC units sold to tenants are released from the additional 15-year extended use period.

¹¹ Immergluck, Dan and Schaeffing, Philip. 2010, October 12. Responsible Lease-Purchase: A Review of the Practice and Research Literature on Non-

Alternatively, an organization can structure their LIHTC properties as conventional rentals, offering all or a portion for lease-purchase or shared equity homeownership in year 15. This approach provides the flexibility to develop a housing strategy that meets the changing needs of existing residents and the broader community.¹² Given that most LIHTC projects are multifamily developments, which may not lend themselves to homeownership, it can be difficult to convert LIHTC units that were not originally intended for lease-purchase. Additionally, some states restrict LIHTC conversions, only allowing scattered site single-family, duplex or townhome units to be transferred to homeownership.

While lease-purchase programs offer a creative way to use the LIHTC program to support shared equity homeownership, these programs are complex to develop and administer.¹³ Structuring and managing the financing within the LIHTC program is difficult,

profit Programs. Retrieved October 2, 2012: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1691194.

¹² NeighborWorks America, 2012, June. Scattered Site Rental Toolkit: Business Planning for Development & Management. Retrieved August 2, 2012: http://www.stablecommunities.org/ssr/0/SSR_Index.htm.

¹³ See NeighborWorks (2012) and Immergluck and Schaeffing (2010) for more on the advantages and challenges of lease purchase programs.

requiring capacity that non-profits may not have. However, shared equity homeownership programs do have the stewardship capacity to provide resident education, counseling, and ongoing support, which are crucial for the success of lease-purchase programs.

Most states (44) incentivize LIHTC projects that provide homeownership opportunities to tenants after the 15-year compliance period (Table 6). Eight states explicitly offer conversion to homeownership as an alternative to the 15-year extended use agreement. In these states, developers can either opt to abide by affordability restrictions for a full 30 years or offer homeownership opportunities to existing residents in year 15 in order to meet threshold requirements.

Only one state, Utah, sets aside funds specifically for projects that encourage eventual homeownership. Utah allocates five percent of tax credits to projects sponsored by government and non-profit developers

that offer homeownership opportunities to tenants after the 15-year compliance period. While four states favor projects that encourage eventual homeownership when application scores result in a tie, most states (67%) incentivize conversion to tenant ownership through points.

Sixty-eight percent of states that incentivize eventual tenant ownership through points offer less than 5% of the total point allocation for this purpose (Table 7). Twenty nine percent offer between 5 and 10% of the points, and Colorado is the only state that deeply incentivizes tenant ownership by allocating more than a quarter (26%) of its total point allocation to applicants who promise to offer homeownership opportunities in year 15.

QAPs provide various levels of detail to explain what a transition to tenant ownership entails. Several states, including Florida and Tennessee, require

Table 6: How States Incentivize Transitions to Tenant Ownership

Incentive Mechanism	# of States	% of States	States
Total	44	86%	AL, AK, AR, AZ, CA, CO, CT, DC, DE, FL, GA, HI, IA, ID, IL, IN, LA, KS, KY, ME, MD, MI, MN, MO, MS, MT, NC, ND, NE, NJ, NV, OH, OK, PA, RI, SC, SD, TN, TX, UT, VT, WA, WI, WV
Threshold Requirements	8	16%	CA, KS, MD, MS, OH, PA, RI, SD
Set-Asides	1	2%	UT
Points	34	67%	AK, AR, AZ, CO, CT, DE, FL, GA, HI, IA, ID, IN, KS, LA, ME, MI, MN, MS, MT, NE, ND, NJ, NM, NY, OK, SC, SD, TN, TX, UT, WA, WV, WI
Tie Breakers	4	8%	AL, IL, NC, VT
None	7	14	MA, NH, NM, NY, OR, VA, WY

Table 7: Strength of Point Incentives for Transitions to Tenant Ownership

Strength of Point Incentive	# of States	% of States	States
Total	34	100%	AK, AZ, AR, CT, CO, DC, DE, FL, GA, HI, IA, ID, UN, KS, LA, ME, MI, MN, MS, MT, NE, ND, NJ, NM, NY, OK, SC, SD, TN, TX, UT, WA, WV, WI
Strong (> 10% of total points)	1	3%	CO
Moderate (5%-10% of total points)	10	29%	DC, FL, IA, LA, MS, MT, NJ, ND, OK, SC
Weak (< 5% of total points)	23	68%	AK, AZ, AR, CT, DE, GA, HI, ID, IN, KS, ME, MI, MN, NE, NM, NY, SD, TN, TX, UT, WA, WV, WI

homeownership plans, homeownership counseling, down payment savings accounts and/or details on purchase prices. PAH organizations are uniquely positioned to score well in this category given their stewardship capacity and experience with providing successful homeownership opportunities for low-income households.¹⁴

- recommend more detailed language around lease-purchase programs that highlight and reward the stewardship components that PAH organizations already have in place;
- encourage partnerships between tax credit project developers and organizations committed to permanent affordability and stewardship.

Conclusion

The existing requirements and incentives that favor extended affordability and homeownership opportunities in state QAPs suggest significant potential for the PAH sector to utilize the LIHTC program as a tool to increase the production of permanently affordable rental and owner-occupied housing while maximizing the public's investment. However, the decision to undertake a LIHTC project requires careful consideration. Given the complexity of LIHTC deals, and the expertise and capacity they require, organizations without tax credit or rental management experience should work with an experienced development partner.

HFAs can enhance LIHTC investment in the PAH sector. HFAs draft QAPs annually providing advocates with an opportunity to influence priorities for the LIHTC program. During the QAP review and comment period, advocates can:

- educate HFAs about the benefits of PAH both in terms of supporting low-income households and preserving limited government subsidies. Organizations should emphasize that while PAH units may cost more up front, they tend to cost less per household over the long term;
- recommend a set aside for non-profit organizations committed to permanent affordability and ongoing stewardship;
- encourage HFAs to require "waiver of qualified contract" language which prohibits developers from opting out of the LIHTC program in year 15;

¹⁴ According to a survey of CLTs, more than half (55%) of respondents reported serving households earning 80% or less of AMI (Thaden, Emily. 2012, January 11. Results of the 2011 Comprehensive CLT Survey. The Housing Fund, Vanderbilt University in conjunction with the National Community Land Trust Network and Lincoln Institute of Land Policy Retrieved April 26, 2012: <http://www.cltnetwork.org/Resources/2011-Comprehensive-CLT-Survey>).

LIHTC Resources

Enterprise Community Investment's guide to LIHTC:
<http://www.enterprisecommunity.com/financing-and-development/low-income-housing-tax-credits>

HUD LIHTC Basics: http://portal.hud.gov/hudportal/HUD?src=/program_offices/comm_planning/affordablehousing/training/web/lihtc/basics

Novogradac Affordable Housing Resource Center,
LIHTC Resources:
http://www.novoco.com/low_income_housing/resources/index.php

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