MIDDLE INCOME HOUSING TAX CREDIT

SENATOR RON WYDEN
RANKING MEMBER, SENATE FINANCE COMMITTEE

SEPTEMBER 22, 2016

Summary of the Discussion Draft

America today faces an affordable housing crisis. Over a quarter of renter households in the United States – more than 11 million people – spend more than half their income on rent. This leaves these renters with too little for other necessities like food, medical care, and transportation. In the meantime, our nation continues to lose affordable housing stock.

Tools like the Low Income Housing Tax Credit (LIHTC), created in 1986, have helped finance 2.8 million affordable homes, assisting 6.5 million households. LIHTC is a critically important federal policy, which encourages the production of affordable housing for low-income families.

The discussion draft proposes a Middle Income Housing Tax Credit (MIHTC) to expand upon the success of LIHTC and provide a robust portfolio of tools to encourage the expansion of affordable housing stock in the United States.

Overview

The proposal would provide housing tax credits for the development of affordable housing for middle-income households.

State Credit Ceiling and Project Allocations

State housing agencies control the allocations of MIHTCs, subject to an annual credit ceiling based on population. Each state receives $1 of MIHTCs per capita, with a minimum annual ceiling of $1,140,000. State housing agencies then allocate the credits to qualifying middle income housing projects. Per project allocations are restricted to no more than the amount necessary for a project to be financially feasible, as determined by the state housing agency.

Any credits not allocated by the state to middle-income projects are carried forward and added to the state's annual allocation of Low Income Housing Tax Credits (LIHTC) for the following year.

Credit Rate

The maximum credit for each project is set to 50 percent of the present value of qualified basis (*i.e.*, the portion of a housing development that is qualified middle-income housing). These credits are then paid out equally over a 15-year credit period. The Treasury Department makes the present value calculation when the project is placed in service or, alternatively, when the taxpayer and state housing agency reach a binding agreement on the credit allocation for the project. The proposal also sets a rate floor of 5 percent per year, subject to the state's credit allocation to the project.

Project Eligibility

To qualify for MIHTC, a taxpayer must have an eligible middle-income housing project: at least 60 percent of the project's units must be rented to individuals with incomes less than or equal to 100 percent of the area median gross income. Projects that receive federal assistance, including grants, credit assistance, or tax-exempt bonds, are not eligible for MIHTC.

A project's middle-income units must also set affordable rents that do not exceed 30 percent of the income of the middle-income tenants. This rental rate includes a utility allowance and household calculation, based on the number of bedrooms in the unit.

If, during the 15-year credit period, a tenant's income increases beyond 100 percent of the area median, the tenant's unit remains a qualifying middle-income unit so long as his or her income does not increase beyond 140 percent of the area median. In that case, the unit no longer qualifies, and, to maintain eligibility, the next available unit must be rented to a middle-income tenant (*i.e.,* with income less than 100 percent of the area median).

Qualified Basis

The amount of tax credits for an eligible project depends on the project's qualified basis – the portion of the project dedicated to affordable middle income housing. This is determined by multiplying the total adjusted basis[1] for an eligible building or project by the fraction of either middle-income floor space or fraction of middle-income units, whichever is lower. The example below illustrates a project meeting the minimum eligibility standards.

Example Middle Income Housing Project

		Total Adjusted Basis:	$10,000,000
Total Units:	100	**Middle Income Units:**	60
		Unit Fraction:	**0.60**
Total Floor Space:	50,000 sq. ft.	**Middle Income Floor Space:**	20,000 sq. ft.
		Floor Space Fraction:	**0.40**

In this example, the floor space fraction is less than the unit fraction, so the qualified basis would be determined by multiplying the floor space fraction (0.40) by the total adjusted basis ($10,000,000), equaling qualified basis of $4,000,000. Assuming the minimum 5 percent per year credit, the annual credit available to the taxpayer would be $200,000.

Coordination with Low Income Housing Tax Credit

The discussion draft allows taxpayers to use LIHTC and MIHTC in combination. However, taxpayers must make an irrevocable election on a building-by-building basis to use one credit or the other. The eligible basis for using LIHTC cannot include the MIHTC basis and vice versa.

Existing Buildings and Rehabilitations

In general, all new buildings that meet the middle-income eligibility standards qualify for MIHTC. Existing buildings, however, must meet several additional criteria in order to be eligible for the credit. These

[1] Adjusted basis excludes any non-residential depreciable property, but includes any common areas available to all tenants.

criteria, similar to rules governing the Low Income Housing Tax Credit, are meant to prevent gaming of the credit and to encourage the expansion of affordable housing stock.

Rehabilitations are treated as new buildings for purposes of MIHTC, so long as the total capital expenditures from the rehabilitation exceed the greater of $6,000 per middle-income unit or 20 percent of the project's total adjusted basis. This calculation excludes acquisition costs, and the rehabilitations must either be made to at least one of the middle-income units or substantially benefit the middle-income tenants.

<u>State Housing Agencies</u>

MIHTC allocations are handled by state housing agencies, which are tasked with developing comprehensive market studies for the areas to be served by prospective middle-income housing projects and providing a publicly available written explanation for MIHTC allocation decisions. All allocations must be part of a housing credit allocation plan that has been approved by a governmental body. Housing plans must clearly lay out project selection criteria and provide procedures to ensure compliance and reporting to the Internal Revenue Service.

Project criteria must take into account location, housing needs, prospective tenant populations, energy efficiency, and a project's potential historical nature. Preferences must also be given to projects obligated to serve middle-income tenants for the longest period of time, projects that house families at a range of incomes between 60 and 100 percent of area median gross income, along with projects situated near transit hubs.

Request for Comment

Comments are requested on all aspects of the discussion draft and related provisions like the Section 42 Low-Income Housing Tax Credit <u>*within 90 days of this release*</u>. While the Ranking Member hopes the policies in the discussion draft will provide a basis for broader tax and housing reform, he also believes this proposal stands on its own merits. As such, comments on the discussion draft will be considered solely in the context of provisions contained in the draft.

Comments on the additional issues listed below are of particular interest to the Ranking Member. All comments should be submitted electronically (preferred) to MIHTC@finance.senate.gov; or to: Senate Committee on Finance, 219 Dirksen Senate Office Building, Washington, DC 20510.

1. **Harmonizing the MIHTC and LIHTC credit and compliance periods.** The discussion draft aligns the MIHTC credit period with the compliance period, making both 15 years, in an effort to simplify the credit's design and administration. (Under LIHTC, the credit period is 10 years, while the compliance period is 15 years). The Ranking Member requests comments on whether the MIHTC credit and compliance periods should be set at 10 years each (which would accelerate the pay out of the credit and shorten the compliance period), whether the MIHTC design should simply mirror the LIHTC design with a 10-year credit period and 15-year compliance period, or some other approach.

2. **Coordinating the use of MIHTC with LIHTC:** The discussion draft describes a regime for using MIHTC and LIHTC in combination for a qualifying mixed-income housing project. The Ranking Member requests comments on the efficacy of this regime. What are possible pitfalls and how can the regime be improved in a way that prevents applying both credits to the same qualified basis (i.e., double-dipping) and minimizes the compliance burden for taxpayers and the administrative burden for state housing authorities?

3. **MIHTC projects and other gap financing:** The discussion draft denies taxpayers the ability to use MIHTC in combination with most other sources of federal housing subsidies (including government grants) in financing the construction of affordable housing. The Ranking Member requests comments on whether a tax credit of 50 percent of present value of qualified basis is sufficient for taxpayers to finance qualifying housing projects under the discussion draft. Is additional gap financing still necessary? If so, should it come from states and localities? Should it be possible to use the credit in combination with other federal grants and subsidies, including tax-exempt bond financing?

4. **MIHTC income targeting**: The discussion draft proposes a credit aimed at building affordable housing for tenants with incomes between 60% and 100% of AMGI. The Ranking Member requests comments on whether a wider range of incomes (e.g., lower, higher, or both) should be targeted and what additional incentives, if any (such as a basis boost or income-averaging) would be needed to still make the credit feasible for taxpayers.

5. **Banks, the Community Reinvestment Act (CRA), and investments in housing projects**: Financial institutions can currently fulfill obligations under CRA by investing in LIHTC or other housing projects with tenants at or below 80% area median income (AMI). In doing so, these institutions supply a critical source of investment capital for affordable housing, and it is anticipated this would continue with MIHTC. *While it is outside the Finance Committee's jurisdiction*, the Ranking Member requests comments on whether or not Congress should also amend CRA to raise the 80% AMI threshold to ensure continued investments by financial institutions in projects aimed at housing persons with income in excess of 80% AMI.