

COMMENTARY**The LIHTC Correction of 2008 and How We Got Here**

By Bob Moss, Boston Capital

You can call this the Correction Year of 2008 for the low-income housing tax credit (LIHTC). Because of several factors, a sudden shift in supply and demand has occurred, and once again the program requires the full attention of Congress. While the credit program itself will survive and reset because of its unprecedented track record and success, the existence of many of the traditional partners—developer entities, housing finance agencies (HFAs), and syndication firms—will be tested.

This is not the first time in the program's history that congressional action has been required. Congress is currently working to ensure that the program receives the upgrades necessary to offset threats that have included inflationary operating costs and unnecessary provisions from the original legislation in 1986. Many of these new provisions remove barriers to the LIHTC that hinder program performance in utilizing other housing financial sources. While the public/private structure of the program will ensure its future, the history of the past 15 years of production tells much about its past and the threats that have been overcome.

The success of the program has always been dependent on the simple fact that investors would be attracted to the program. Until permanence of the program by Congress in 1993, the investor market for the program, then six years old, was made up of a few corporations and a number of public/retail funds for individuals. Because the program was renewed annually by Congress until 1993, the investor market was in its infancy. Still subject to annual appropriations review, most of the equity raised to buy the credit was raised from individual investors using systems for syndication that companies already had used throughout the 1980s. In 1993, Section 42 of the Internal Revenue Code

was made permanent in the Omnibus Appropriations Act; introduced by Ways and Means Committee Chairman Dan Rostenkowski and signed into law by President Bill Clinton. For the investor market, the permanence of the program coincided with a growing interest by corporate investors in large urban markets.

In 1993, state housing finance agencies authorized to allocate the credit were staffed by housing officials not too far removed from the uncertainty of the early years and the original implementation of the program. The qualified allocation plans (QAP) were designed to allocate credits to properties that met the original intent of Section 42 and insure that the product was being built and managed by sponsors with sufficient track record and experience.

Also at that time, other federal housing production programs were still in play; producing rural (FmHA 515) and senior (HUD 202) properties. There was less pressure on each state's QAP for the LIHTC to produce various set-asides and carve up the per capita allocation (then \$1.25). By the end of the '90s, two factors evolved that started to make the QAPs more complex: 1) the QAPs kept growing layers of complexity as current HFA staff, 14 years removed from the inception, kept adding scoring categories, and 2) the reduction of federal housing dollars for other programs and the increased focus from those housing sponsors on the credit. Housing sponsors from expired rural, special needs, and elderly programs, well trained in advocacy from their previous experiences, now wanted their piece of the pie. Both of these factors were supported well into the current decade by an investor market with a healthy supply of capital.

By the end of the '90s, the public/retail market started to wane as the corporate market started to deliver lower

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yields and higher pricing. Interestingly, the majority of corporate investors at that time were “economic” investors interested in using the credit for tax offset. As we entered the year 2000, The Community Reinvestment Act (CRA), a bill first passed by Congress in 1977 and designed to encourage banks to lend and invest in low- to moderate-income neighborhoods, was the driving force in changing the make-up of corporate investors from economic to CRA-driven investors. By 2007, CRA-driven investors in the LIHTC made up two-thirds of the corporate market, and had driven yields downward in an effort to meet their CRA obligations.

In the Correction Year of 2008, LIHTC funds are once again fighting to regain the diversity of having both economic and CRA investors. After-tax yields have returned to a level that appears to be attractive to both types of investors, and with Congress proposing alternative minimum tax (AMT) corporate relief for investors in the LIHTC there is hope that the GSE investment levels will return.

While there will still be pressure on housing sponsors, developers and allocating agencies to make transactions feasible at lower equity pricing, several important corrections will help the program:

1. Sponsors and developers with solid track records and financial liquidity for guarantees will return,
2. QAP policies for allocation will account for deal structures with certain equity placement, and
3. the positive action of Congress to upgrade the LIHTC will allow other sources of housing capital to more easily support each transaction. ❖

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ISSN 1940-4980

The Journal is printed using non-toxic soy-based ink. Novogradac & Company LLP encourages readers to recycle.

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