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NATIONAL AFFORDABLE HOUSING MANAGEMENT ASSOCIATION

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Tax Reform: Impact on the Housing Credit Program

The Low-Income Housing Tax Credit (LIHTC) was established in 1986, during the last major tax code overhaul. Since that time, LIHTC has become the nation's primary financing tool for the development and preservation of affordable housing, accounting for over 3 million affordable rental units and providing homes for nearly 7 million low-income families. Over three decades later, tax reform is again underway in Congress and the future of the LIHTC has been thrown into uncertainty.

This NAHMAnalysis discusses the impact of the House and Senate tax reform bills on the Housing Credit program, including a look at the potential market impact over ten years and the next steps for Congress.

Tax Reform Efforts in Congress

Congressional efforts to change the tax code put Washington, D.C., in a frenzy. Two separate tax reform bills emerged – one in the House, and one in the Senate – sharing some similarities but also diverging in their impact on affordable housing.

Following the vote on the House version of the "Tax Cuts and Jobs Act," which passed in November by a healthy margin, the Senate recently passed its bill in the early morning hours of December 2, 2017. A final step involves reconciling the two separate bills to final legislation for both House and Senate passage, before it can be signed into law by President Trump. On Monday, December 4th, the House voted to proceed to conference committee and begin the reconciliation process; soon thereafter, the Senate also voted to move to conference committee.

Impacts on the Housing Credit

The broad and bipartisan Congressional support for the Housing Credit has given critical protection to the program. In fact, while other exemptions and deductions in the tax code have been axed under the pending overhaul, both the House and Senate versions of tax reform retain the LIHTC, although with some modifications.

However, the LIHTC depends heavily on other factors in the tax code – such as the corporate tax rate that underwrites institutional capital invested in the program; the tax exemption on state bonds that are tied to the 4% credit rate for investors; and the status of the "base erosion" tax for foreign-held investment capital – each of which heads for upheaval as tax reform makes its way through the final stages in Congress.

"Tax Cuts and Jobs Act" – Bill Comparison

The House bill has less favorable language with regard to affordable housing, as *it completely eliminates* the tax exemption for Private Activity Bonds (PABs), including the multifamily housing bonds. Multifamily bonds are accompanied by the 4% Housing Credits, accounting for over 50% of all Housing Credit production. In addition, the bill does not offset the impacts of a reduced corporate rate (35% to 20%) on the value of Housing Credits. A lower corporate tax rate reduces the value of losses from Housing Credit investments, in turn reducing Housing Credit prices by about 15%. This would reduce the amount of equity capital invested in Housing Credit properties. The House bill in particular could *reduce affordable rental production by more than 50*% annually, primarily through the elimination of the tax exemption of PABs.

Although the Senate bill preserves PABs, the bill would still negatively impact the LIHTC program through changes to the Base Erosion tax, the lowered corporate rate (35% to 20%), and adjustments to pass-through benefits. Similar to the House bill, *a lower corporate tax rate* reduces the value of losses from Housing Credit investments, in turn reducing Housing Credit prices by about 15%. This would reduce the amount of equity capital invested in Housing Credit properties.

In addition, a number of investors would see elimination under the Senate version of the bill as a result of the *Base Erosion and Anti-abuse Tax (BEAT).* The Senate provision does not permit business credits (other than Research and Development) to be used against the BEAT; this will remove investors that account for between 10% and 25% of the capital invested in the Housing Credit. The bill *lengthens the depreciation period* for nearly all residential real estate properties from 27.5 years to 30 years, but also permits, for a period, expensing of personal property and land improvements.

The Senate bill treats rural areas as "difficult development areas," which would qualify these areas to receive a "basis boost" toward the development. However, the bill also *reduces the overall basis boost* available to designated properties from 30% to 25%, offsetting the effects of including rural areas in the designation. This will make it more difficult to undertake development activities in hard-to-reach markets experiencing higher production costs, lower incomes, or both. The bill clarifies that Housing Credit properties can exclusively be set aside for veterans, while removing the current exception for artists' housing. Removing the artists' safe harbor would put all existing artist housing at risk for tax credit recapture.

Overall, the tax reform bills take a mixed approach to affordable housing – preserving the Housing Credit program but proposing harmful provisions to save costs. Though the Senate bill is more favorable for the LIHTC program, tax reform overall may result in negative consequences for affordable housing. The LIHTC market has already suffered from the uncertainty brought on by both the tax reform proceedings and the delayed annual appropriations process. The volatility is compounded by a recent report from the bipartisan Joint Committee on Taxation, which predicted over $1 trillion added to the federal deficit as a result of the tax reform plan (after accounting for economic growth). As a result, the deficit discussion will likely come into further focus for Congress; the affordable housing industry will again be faced with more uncertainty, as spending cuts and program eliminations will be proposed under deficit reduction efforts.

Missed Opportunities and Broader Implications

Not only do the tax reform bills represent a significant threat to affordable housing supply over the next decade, but they also represent a tragic missed opportunity to mitigate our country's affordable housing crisis by strengthening and expanding the Housing Credit program. Separate legislation introduced earlier in the year, titled the "Affordable Housing Credit Improvement Act" (S. 548 / H.R. 1661), proposed key provisions to strengthen the program (such as expanding the credit allocation by 50%, allowing for income-mixing, making permanent the 4% credit rate, and additional reforms).

The legislation enjoyed bipartisan support in both Chambers and gained momentum over the summer with endorsements from top legislators, including the Chairman of the Senate's tax-writing committee. However, tax overhaul efforts soon shifted to an emphasis on cost-savings to offset the tax revenue lost under the sweeping reform plan. As a result, initiatives to improve the LIHTC as part of tax reform have given way to an industry-wide effort to merely protect the program. Even no-cost provisions of the "Affordable Housing Credit Improvement Act" were not incorporated in the Senate final bill after being approved by the Senate Finance Committee.

Conclusion: NAHMA Position and Advocacy Requests

NAHMA has been a strong supporter of the LIHTC and has worked diligently to protect and further improve the program. Along with our industry colleagues, our main priority over this year has shifted from strengthening the Housing Credit program to preserving it throughout the tax reform process.

Our primary objective throughout the tax reform debate remains as follows:

- Preserve the tax exemption on Private Activity Bonds (specifically Multifamily Housing Bonds);
- Insulate the Housing Credit value from a reduced corporate tax rate; and
- Commit to protecting and strengthening Housing Credit investment into the future.

Throughout 2017, NAHMA members have actively responded to nationwide grassroots alerts by contacting members of Congress, appealing to legislators through social media and op-ed articles in local newspapers, and hosting lawmakers for affordable property tours.

We are heartened by the level of outreach by NAHMA members during this urgent time, and ask that the efforts continue throughout the implementation of tax reform and the appropriations process. Although NAHMA and industry partners saw this year's comprehensive tax code overhaul as an opportunity to make improvements to the LIHTC, reforming and expanding LIHTC is still possible through separate legislation. Please stay tuned for our ongoing grassroots alerts as we advocate in Congress on behalf of both the industry and the communities we all serve.