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Important new changes to LIHTC law made by Consolidated Appropriations Act of 2018

By Rick Goldstein and Forrest Milder

We write to bring your attention to two important changes to the Low-Income Housing Tax Credit (LIHTC) that are in the just-adopted Consolidated Appropriations Act of 2018. The new provisions were originally part of the Cantwell-Hatch and Tiberi/Curbelo-Neal bills, often referred to as "The Affordable Housing Tax Credit Improvement Act." Working with industry groups, Nixon Peabody had a hand in drafting the legislation, and we will be pleased to work with you in applying the new provisions.

Here's a summary of the new rules.

Increase in available credits

The allocation authority for the 9% credit is increased temporarily by 12.5% for four years, beginning with 2018. This year, the available LIHTC will be the greater of $2.70 per resident or $3.110 million. For 2019–2021, the inflation factor applies, so it's possible these amounts could increase over one or more of the next three years. After that period, unless a future Congress takes action, the allocation amounts will revert to the pre-increase levels, but still will take the inflation factor into account.

Income averaging

For the first time, the Act makes it possible for units to qualify as "low-income" even if some have tenants with income as high as 80 percent of an area median income ("AMI").

For the last 30 years, a project has had to elect that ***either*** (A) 20 percent of its units would be occupied by tenants at or below 50 percent of AMI, or (B) 40 percent of its units would be occupied by tenants at or below 60 percent of AMI (these rules, which also include an adjustment for family size, are often referred to as the 20-50 or 40-60 "minimum set-asides"). For example, under the old law, an owner who wanted 10 units to be considered low-income under the 40-60 test would have to have all 10 occupied by tenants at or below 60 percent of AMI.

The new law makes a significant change to this rule. It allows owners a third alternative known as "income averaging." Under the new rules, at least 40% of the low-income units must ***average*** 60% of AMI, provided that no low-income unit's occupants may exceed 80% of AMI. To do this, an owner will literally designate units at any of the following percentages: 20, 30, 40, 50, 60, 70 or 80, provided that all of the low-income units taken together will ***average out*** to not more than 60 percent.

Note that many combinations can work under the new rule. For example, five units at 80 percent of AMI and five at 40 percent would work, since, on average, all of the units ***average*** 60 percent. Or, an owner with 10 units could have three units at 80 percent of AMI, five units at 60 percent, and two units at 30 percent. Here's the math: (3 x 80= 240) + (5 x 60=300) + (2 x 30 = 60) = 600 divided by 10 equals 60.

Note that floor size ***does not affect this first computation***. For example, in the preceding example, it doesn't matter if the units designated 80 percent units are three-bedroom units while the 60 and 30 percent units are only one- or two-bedroom units. Each rental unit, regardless of size, still counts as "one unit" in the computation.

On the other hand, as under prior law, if there are market-rate units, floor size can still matter when it comes to computing the square footage of the low-income units and the building's "qualified basis." In that case, the total square footage of the low-income units would be compared to the total square footage of all units and the "applicable fraction," used to determine the qualified basis, would be based on the *lesser* of (A) the ratio of low-income units to total units or (B) the ratio of total square footage of low-income units to the total square footage of all units. As a result, developing larger, three-bedroom units with 80 percent of AMI occupants might account for more floor space and thereby avoid reducing the qualified basis and, thus, LIHTCs in some buildings that have both low-income and market-rate units.

The legislation also makes changes to the "next available unit" rule if the owner makes an income averaging election. If any tenants go "over income," the next available unit must meet somewhat-complex requirements, leading to additional record-keeping to assure compliance. We are continuing to study the application of these new rules and will update you as more clarity is available.

Of course, this is brand-new law and, as might be expected, a number of open questions remain about how income averaging will operate. In particular, even though the new law is effective immediately as to minimum set-aside elections made after March 23, 2018, we don't yet know if it could be applied to projects that have not yet made this election (which is accomplished, as a technical matter, when the owner completes the Part II of the Form 8609) but which have already been awarded credits based on the old 20-50 or 40-60 minimums that are in every state's Qualified Allocation Plans ("QAPs"). Perhaps state agencies will have to first revise their QAPs, and then apply the income averaging rules on a going-forward basis. Similar changes were not made to the tax-exempt bond rules, so some care will have to be exercised to assure that a project that elects income averaging still passes at least the 20-50 or 40-60 test for bond purposes.

For more information about the new tax law and its application to tax credits, please contact your Nixon Peabody attorney, members of our Tax Credit Finance & Syndication Group, or the authors of this alert:

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