



Low-Income Housing Tax Credit Program

What is the Low-Income Housing Tax Credit program?

The Low-Income Housing Tax Credit (LIHTC) program was established by the Tax Reform Act of 1986 (Internal Revenue Code Section 42) to create market incentives for the acquisition and development or rehabilitation of affordable rental housing. Over the last two decades, this program has become an important tool for addressing the nation's affordable housing needs.

How does the program work?

The LIHTC program authorizes state housing credit agencies (HCAs) to award 9 percent and 4 percent federal tax credits to developers of affordable rental housing. The tax credits are used by developers to raise equity financing for their projects.

The equity capital generated from the tax credits lowers the debt burden on LIHTC properties, making it easier for owners to offer lower, more affordable rents; while investors, such as banks, obtain a dollar-for-dollar reduction in their federal tax liability.

National banks can invest in LIHTC projects by making direct investments in affordable housing projects and investments in funds comprised of multiple projects. These investments will receive a stream of tax credits during the initial 10 years of a 15-year tax compliance period. Such investments are typically structured as real estate limited partnerships or limited-liability companies.

Thus, a national bank, as a limited partner or limited-liability member, can generate additional returns with the pass through of depreciation and cash flow in these real estate investments.

How are tax credits awarded?

Under the authority of the Internal Revenue Service (IRS), state HCAs administer the LIHTC program through qualified allocation plans (QAPs). States are allowed to set specific allocation criteria for awarding tax credits and must develop QAPs that identify and prioritize housing needs, especially for low-income renter households. Criteria used to guide the selection of projects awarded tax credits must also be included in a state's QAP. HCAs award tax credits to developers based on the housing needs identified and selection criteria established.

At the state level, the annual volume cap for the 9 percent tax credit is equal to the state population multiplied by a fixed per capita rate. The 4 percent tax credit allocation is based on the state's volume cap for private activity bonds, which is equal to the state population multiplied by a per capita rate. In each case, these two per capita rates are adjusted annually for inflation. Nonprofit and for-profit developers apply for the tax credits to build and rehabilitate affordable rental housing. Tax credits are available only to help cover the cost of units within qualified projects reserved for rental to low-income households.

How can LIHTCs benefit a bank?

Banks choose to invest in LIHTC projects for several reasons. Investments in LIHTCs can earn attractive rates of return, with yields above the 10-year U.S. Treasury bond rate. They also can spur on additional commercial lending opportunities with existing customers and newly established banking relationships.

Banks will also receive positive CRA consideration for such investments provided they benefit a bank's assessment area. Banks may receive positive CRA consideration for investments made in LIHTC projects and funds that benefit a broader statewide or regional area that includes the bank's assessment area(s), provided they have otherwise adequately addressed the community development needs of their assessment area(s). Similarly, banks will receive CRA consideration if they provide predevelopment financing or construction/permanent financing to LIHTC projects and funds.

Investments in LIHTC projects (or a fund consisting of several projects) are eligible investments for national banks under the OCC's Part 24 authority. The OCC maintains a list of national and regional LIHTC funds in which national banks have invested on its Web site at:

<http://www.occ.treas.gov/cdd/fundslist.htm>

What are the risks to bank investors?

A bank should consider the compliance, tax planning, underwriting and credit, liquidity, and operational/reputation risk of any investment it may make.

To take full advantage of the tax credits under the LIHTC program, a bank should have taxable income projected for the term of the investment and evaluate its exposure to the alternative minimum tax. LIHTCs are subject

to recapture if a project fails to maintain affordability for a 15-year compliance period.

Bank investors typically underwrite LIHTC investments as commercial real estate transactions. A bank investor must perform front-end due diligence to ensure satisfaction with the financial capacity, performance, management capacity, and expertise of the project developer and general or managing partner.

As an investor in a multifamily property operating for a minimum of 15 years, a bank must be comfortable with projected reserves, debt service coverage, and guarantees. Portfolio diversity also is an important underwriting consideration when a bank is deciding whether to make LIHTC investments. Once a transaction meets a bank's underwriting criteria, the bank can evaluate the transaction from an investment perspective.

Banks should consult their own tax advisors about the tax treatments and consequences that may apply to their own transactions.

How has the Housing and Economic and Recovery Act of 2008 (HERA) improved the LIHTC program?

Enacted on July 30, 2008, HERA, has several provisions pertaining to the LIHTC under Section 42 of the Internal Revenue Code of 1986. Some of the provisions of most interest to banks are highlighted here.

- Permits housing tax credits to offset AMT liabilities.
- Increases liquidity of tax credit investments by eliminating recapture bond requirements.

Additional information on HERA can be obtained at:

http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_public_laws&docid=f:publ289.110.pdf.

For more information

- Learn more about how LIHTC's work at:
<http://www.occ.gov/ftp/release/2008-10a.pdf>
<http://www.occ.treas.gov/cdd/Spring06/index.htm>
<http://www.occ.treas.gov/cdd/taxcreditsoh.pdf>
<http://www.occ.treas.gov/cdd/taxcredit101.pdf>
- Learn more about community development opportunities generally at:
<http://www.occ.treas.gov/cdd/resource.htm>
- Specific information on LIHTC projects can be obtained at:
<http://www.huduser.org/datasets/lihtc.html>
- OCC's District Community Affairs Officers whose contact information can be obtained at:
<http://www.occ.treas.gov/cdd/commfoc.htm>