HOUSING

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IRS Releases New Guidance on 4% LIHTC Credit Rate Floor

Federal legislation enacted at the end of 2020 created a 4% floor for federal low-income housing tax credits associated with tax-exempt multifamily bonds, but was ambiguous with respect to projects still under construction with bonds issued before 2021. The 4% floor greatly increased the value of such credits because of currently low interest rates. On December 1, the IRS released new guidance on low-income housing tax credits specifically for projects with tax-exempt bond issuances and tax credit awards that first occurred prior to December 31, 2020, but which had not yet been placed in service as of that date, addressing whether these projects could benefit from the 4% floor if additional bond draws, supplemental bond issuances, or additional tax credit awards were made after 2020. This guidance may provide opportunities to some HFAs to afford developers the chance to qualify for the 4% floor, thus generating additional tax credits which can be used to benefit the project and its tenants.

IRS Revenue Ruling 2021-20 and Revenue Procedure 2021-43, released together on December 1, 2021, provide clarification to the legislative ambiguities. Of primary importance to bond-financed projects, the guidance indicates the following with respect to the condition that a project be financed by tax-exempt obligations issued after December 31, 2020:

1. The condition will not be met by a draw-down bond issue originally issued prior to January 1, 2021, even if some of the draws occur after 2020.
2. For projects for which tax-exempt bonds had already been issued by December 31, 2020, the condition can still be met by a second, separate bond issue which is issued after 2020. However, a new bond issuance in a de minimis amount is not sufficient; to satisfy the safe harbor provided in the guidance the second bond issuance must comprise at least 10% of all tax-exempt debt issued for the project.

The bottom line is that HFAs may be able to assist a project in qualifying for the 4% floor by cooperating with a supplemental bond issuance for the project. Depending on various factors, this could potentially be done as a single-project financing or, in the context of pooled transactions, through a combination of new issuance and re-allocation of existing bond proceeds. However, the recent guidance strongly suggests that to take these steps merely to increase the returns of the developer or project owners would not be consistent with applicable regulations, which include an overarching provision intended to

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limit the amount of tax credits to the amount actually needed for the financial feasibility of the project. Because the plan of finance for an already-underway project was presumably found sufficient with a lower tax credit amount, some change in the project's circumstances or its plan of finance may be necessary in order to justify the increase in credits. On the bond compliance side, the need to avoid an over-issuance of bonds for the project may likewise necessitate some reasonable basis for the additional issuance.

For example, the issuance of a supplemental bond issue for a project on or after January 1, 2021, and then redemption of those same bonds shortly after issuance, may be inconsistent with the IRS intentions regarding the qualification of the project for the 4% credit floor. In any case this may dovetail with an HFA's desire to work with project developers to use the potential boost in credits to address any budget overruns (e.g., increased costs for materials and/or labor), increase the number or affordability of units at the project, plan enhancements to the units or the project's common areas, or improve the project in some other manner consistent with the HFA's mission. Note that a supplemental issuance of bonds will require compliance with the private activity bond volume cap requirements under Section 146 of the Internal Revenue Code.

Please contact one of the attorneys in Kutak Rock's Housing Finance Agency Practice Group or National Public Finance Tax Group with any questions you may have on the new guidance. We would note that Kutak Rock regularly represents those participating in the low-income housing tax credits marketplace, and this experience assists us in providing well-rounded and practical advice consistent with the market.