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Leveraging the New 4% LIHTC Rule This Year

As reported extensively, the recently enacted One Big Beautiful Bill (H.R.1) provides positive changes for HFAs: (1) a 12% increase in the annual amount of 9% Low Income Housing Tax Credits beginning in 2026, (2) a permanent extension of the New Markets Tax Credit program, and (3) a reduction from 50% to 25% of the amount of tax-exempt multifamily bonds required for 4% Low Income Housing Tax Credits (LIHTCs). The latter change comes with restrictions, and also offers some potential, but problematic, opportunities to leverage 2025 Private Activity Bond cap.

The 4% LIHTC change has two important timing requirements: (1) at least 5% of the aggregate basis of any project must be financed by tax-exempt bonds issued after December 31, 2025, and (2) the project must be placed in service after December 31, 2025.

The fact that only 5% of the aggregate basis of a project needs to be financed by tax-exempt bonds issued in 2026 or later creates a potential opportunity to leverage 2025 4% LIHTCs by funding only 20% of a project with tax-exempt bonds issued in 2025 and another 5% by bonds issued in 2026. However, there are some federal tax restrictions on doing so, as well as practical considerations:

1. Based on existing law, a structure is clearly OK if the 2025 and 2026 bonds issues are separate issues for tax purposes, meaning they need to be separate issues priced at least 15 days apart, but common security is OK.
2. It is not presently clear if other potential structures—such as a single draw-down instrument issued in 2025 but with draws in both 2025 and 2026—could utilize the new 25% test. The ambiguity arises from what the words "an issue" and "issue date" mean in this context.
3. How can an HFA assure a developer in 2025 that it would issue tax-exempt bonds in 2026, and that the HFA would have PAB cap for such purposes? Perhaps a commitment to issue bonds in 2026 and use 2026 PAB cap before other projects—like HFAs do for a 9% LIHTC forward commitment.
4. Would there be two loans for a project (and if so, possibly at different interest rates), and how would that work practically? The additional loans financed by supplemental bond issues to meet the 50% test resulting from COVID era cost increases may be a good guide.
5. Will LIHTC investors be comfortable with these risks, or will they lower their pricing as a result?

If you have any questions, please contact one of the attorneys listed on the left in Kutak Rock's Housing Finance Agency Practice Group or National Public Finance Tax Group.

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