How Does the Low-Income Housing Tax Credit Work?

IRS

Every year the federal government issues housing tax credit capacity to each state in an amount based on its population.

est. $11M annually

AHFA

States allocate housing tax credits for approved affordable housing developments on a competitive basis each year. For purposes of this example, the annual tax credit is eligible to a development annually for ten years.

$800,000 in annual tax credits (10 yrs.)

DEVELOPMENT

Conventional Mortgage Loan	=	$2.5 million
Tax Credit Equity	=	$7.1 million
Owner Contribution	=	$400,000
Total Costs	=	**$10 million**

This graphic explains how tax credits allocated to a project generate cash equity which, in turn, is invested into the development to reduce its overall debt. This process requires developers to make rental prices affordable for income-eligible renters up to 30 years. Amounts reflected in this example are for illustration purposes only.

$2.5M mortgage

$7.1M in equity

$800,000 in annual tax credits (10 yrs.)

LENDER

Typically 50-70% of the financing comes from tax credit equity, 20-25% from mortgage debt, and the remaining contribution comes from various other sources.

SYNDICATOR / INVESTOR

The owner of the development will sell the annual $800,000 housing tax credit allocation to a syndicator. Syndicators convert tax credits into equity by selling them to investors who utilize the credits to offset tax liability. Equity is used along with debt and other sources to finance the development.

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Recognizing that the business community often lacks economic incentives to invest in low-income housing, the U.S. Congress instituted the Low Income Housing Tax Credit (LIHTC) program as part of the Tax Reform Act of 1986. Since then, it has become the largest production driver of new and rehabilitated affordable rental housing in the nation.

Housing credits provide a federal income tax credit as an incentive to investors, primarily institutional. Investors may receive a dollar-for-dollar credit against their federal income tax liability each year for 10 years. In exchange for receiving the credit, investors and/or owners must reserve a percentage of units, generally 100 percent in Alabama, for the area's lower-income residents, based upon the area's median income.

1. Federal government issues tax credit capacity to states. Each state gets a fixed allocation of credits based on its population.
2. AHFA conducts a competitive application cycle and strives to distribute credits throughout the state to areas with the greatest needs.
3. Developers apply for tax credits.
4. AHFA approves developments to receive LIHTC allocations, based on stated criteria.
5. Developers sell tax credits to syndicators/investors for cash -- which is invested directly into the project.
6. Developer begins construction on property.
7. About two years after process begins, residents move in. Rents are restricted according to number of bedrooms, resident income, and area median income.
8. Investors receive 10 years of tax credits based on the cost of construction or rehab of apartments.
9. AHFA, syndicator, lender, and investor monitor development for compliance. Property and units must remain affordable to low-income families for 30 years.