

Proposal to Prevent the Loss of Affordable Housing

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Summary

The Low-Income Housing Tax Credit (Housing Credit) is our nation's most successful tool for encouraging private investment in the production and preservation of affordable rental housing. Since its creation in 1986, it has financed over 3 million affordable apartments, providing homes to roughly 7.2 million low-income households, while transferring risk from the government to the private sector. However, there is an emerging practice that poses a threat to the affordability of Housing Credit units and is limiting the full benefits of the program.

Housing Credit properties are subject to a minimum 30-year affordability commitment: a 15-year initial compliance period enforced by the IRS through tax credit recapture rules, and a minimum 15-year "extended use" period enforced by state administration of the program and a deed restriction recorded against the property. A number of states either require or incentivize even longer affordability periods.

This paper discusses an issue with the qualified contracts provision in Section 42 of the Internal Revenue Code that permits owners to take properties out of the program after just 15 years, thereby releasing these properties from the 30-year affordability commitment. This situation has recently come to the attention of the affordable housing community and requires prompt action at the federal level.

About Qualified Contracts

There are two exceptions to the requirement that Housing Credit properties remain affordable for 30 years: 1) in the case of foreclosure; and 2) where a "qualified contract" is presented to the state Housing Credit agency. Under the qualified contract provision, an owner of a Housing Credit property may, after Year 14, approach the Housing Credit allocating agency to request a qualified contract. This request begins a one-year period during which the allocating agency seeks a qualified buyer to purchase the property and maintain it as affordable for the duration of the extended use period. The required purchase price for a qualified contract is stipulated by Section 42 and was designed to prevent backend windfalls to owners and investors by limiting them to an inflation-adjusted return on the original equity contribution.

While the original intent of this provision was to create a limited return and some liquidity for investors at a time when the Housing Credit was an unproven program, it has come to function as a loophole that allows a nearly automatic affordability op-out after just 15 years of affordability. This is because the qualified contract formula price in nearly all cases significantly exceeds the market value of the property as affordable housing. As a result, it is extremely rare for the allocating agency to find a buyer willing to pay the qualified contract price. If the allocating agency fails to identify a qualified buyer within one year, the property is released from the affordability requirements of the Housing Credit program. At that point, the owner is free to either sell the property at market value without any deed restriction or the owner may continue to own and manage the property charging market rents.

What is the Extent of the Problem, and Why Now?

In recent years, many rental markets have heated up considerably. According to the U.S. Census Bureau, on average apartment rents have climbed by over 42 percent in the last decade. This means that in many markets, Housing Credit properties could demand far higher rents if they did not have the deed restrictions required by the

program. This creates an incentive for owners to seek a way to lift the affordability restrictions on their properties even though such action was not contemplated when the property was originally financed with Housing Credit subsidies. Housing Credit properties located in high opportunity areas or areas that have gentrified since the property was placed in service are most at risk. These neighborhoods are often the most difficult to develop new affordable housing in and/or are experiencing high rates of displacement of low-income households, so preserving existing units is extremely important.

More owners are using qualified contracts as a strategy to flip Housing Credit properties to market—and thus capitalize on the differential between affordable and market rents—after only 15 years of affordability, a far shorter affordability period than Congress intended. Recent analyses indicate that the qualified contracts process is resulting in the premature loss of well over 10,000 low-income units annually. As of 2017, approximately 50,000 units nationwide have already been lost, and in that year alone, owners served notice to state allocating agencies that they wanted to begin the qualified contract process on additional properties comprising approximately 18,000 units.

Affordable housing advocates are deeply concerned that unless the qualified contract process is corrected, the number of Housing Credit properties lost before fulfilling their intended 30-year affordability period will continue to grow at an accelerating rate.

Correcting the Qualified Contract Problem

While some states have or are in the process of implementing policies to mitigate as best they can the loss associated with qualified contracts, federal legislation is required to correct the qualified contracts provision in Section 42. Legislation has been prepared for introduction in the 116th Congress that would address the problem by:

- Repealing the qualified contract option in Section 42 for future developments (after December 31, 2018), thus eliminating the qualified contract provision being used as an opt-out for properties awarded credits or bonds beginning in 2019; and
- Correcting the statutory price for purchase of existing properties so that it is based on fair market value of the property as affordable housing.

Affordable housing practitioners and advocates agree that it is imperative that Congress correct the qualified contracts loophole to ensure that the Housing Credit can fulfill its intended program goal of financing at least 30 years of affordability for low-income residents.

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Local Initiatives Support Corporation/National Equity Fund
Low Income Investment Fund
National Association of Affordable Housing Lenders
National Association of State and Local Equity Funds
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National Housing Conference
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National Housing Trust
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