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Setting Up for Success: the New 25% Financed-By Test for 4% LIHTC-Bond Transactions

THOM AMDUR, LINCOLN AVENUE COMMUNITIES

The enactment of the One Big Beautiful Bill Act (OBBBA) represents a remarkable achievement for affordable housing advocates and a landmark moment for proponents of the low-income housing tax credit (LIHTC). The permanent reduction of the 50% test and the permanent 12% expansion of 9% LIHTC allocations have been key policy priorities for a decade and their enactment checks off two of the most important provisions of the Affordable Housing Credit Improvement Act (AHCIA).

As readers likely know, Novogradac estimates that these provisions alone will help create more than 1.22 million additional affordable homes over the next 10 years, positively impacting the lives of countless families, seniors and individuals nationwide.

The passage of the OBBBA completes an important leg on what has been a long and winding journey that started nine years ago with the initial introduction of the AHCIA and came heartbreakingly close to passing last year as part of the Smith-Wyden tax bill. While this is a significant policy win for the industry now that it has been enacted, it is time to refocus on addressing the deficit of 7.1 million homes across the country and ending of the affordable housing crisis through a strategic and coordinated effort by public, nonprofit and private sector stakeholders.

The new 25% test has the potential to supercharge affordable housing production through the 4% LIHTC, but we must recognize that the housing deficit is large and potential new production from the OBBBA can easily be stymied by externalities, including interest

rate volatility, inflation, rising labor costs, reduced access to subordinate financing, declines in equity pricing and NIMBYism. To minimize the impact of these externalities and deliver on the promise made to Congress and the low-income households across the country, it is critical that LIHTC stakeholders, including housing finance agencies, local governments and developers recognize and take decisive and proactive steps to help the 4% LIHTC and 25% test meet their maximum potential. Below are proactive strategies HFAs and stakeholders should consider to best leverage the new policies to create housing and help communities thrive.

Private Activity Bond Stewardship

States that have historically been oversubscribed for private activity bonds (PABs) should immediately require developers to scale back PAB requests to the new bond test threshold to the extent that it is financially feasible. HFAs that directly administer PABs should consider adopting policies that mandate applicants cannot request PABs more than the greater of 30% of aggregate basis or an amount necessary for

permanent financing. Recognizing that some housing credit allocating agencies do not administer PABs, we encourage these agencies to adopt complimentary policies that prohibit the award 4% LIHTCs to tax-exempt bond (TEB) projects that request or obtain more PABs than necessary achieve the above recommendation. Furthermore, HFA's that have already made PAB awards for developments that will close in 2026 and could thus take advantage of the new 25% test should consider adopting incentives for developers to voluntarily scale down current volume cap allocations.

We recognize that scaling PAB requests down to the 25% test will necessarily result in diminished permanent loan proceeds, as a greater proportion of a 4% LIHTC developments capital stack is comprised of higher-interest rate taxable debt. There are many overlapping strategies HFAs can implement to minimize these gaps beyond traditional gap funding sources. For example, adopting a bond recycling program is a proven strategy to replace “taxable tails” with “tax-exempt tails.”

Basis Maximization

HFAs can also revisit per-unit or per-development caps on 4% LIHTCs as well as constraints on potential eligible basis, including caps on acquisition basis and/or developer fees caps for TEB transactions. It is a great policy outcome if developments can leverage additional equity to fill gaps instead of scarce subordinate financing resources.

Increasing developer fees in an amount that offsets the lost debt proceeds can generate additional LIHTC equity to fill project gaps and also is justifiable under Internal Revenue Code Section 42 and IRS guidance on developer fee sizing, which recognizes that fees can be differentiated based on the risk profile of varying profiles. This could be done on a uniform basis or structured on a discretionary basis as a supplemental “hardship” developer fee when certain financial distress conditions, as has been deployed historically by Arizona's

Department of Housing and is under consideration in emergency regulations from the California Tax Credit Allocation Committee. When leveraging this strategy, we recommend that HFAs require developers to defer any increase in developer fees above their current limits. This will align incentives to accommodate feasibility without increasing paid fees.

Prioritize Multifamily PABs

It is essential that state governors, treasurers and their respective bond allocation agency boards allocate adequate PABs for multifamily housing. At the same time, in today's challenging federal appropriations environment, there may be more pressure to use PABs for economic development, single-family homes, etc. Balanced policies are key and it is important to emphasize in conversations with policymakers that the impact of the 25% test will be mitigated significantly if insufficient PABs are dedicated to multifamily housing.

Embrace the Abundance/State Capacity Libertarianism Frameworks

It is the perfect time for state housing finance agencies and state and local governments to review their affordable housing priorities and lean into policies and procedures that will help developers maximize LIHTC production in the 4% LIHTC program. This starts with a simple statement of mission and goals in qualified allocation plans (QAPs), consolidated plans and related governing documents that articulate that efficient, scaled production of high-quality housing production is a top priority.

The 4% LIHTC is an efficient workforce housing production tool. However, the LIHTC has over time been asked to solve many other societal challenges which has layered it with costly requirements that diminish its ability to maximize what it is best at—namely housing production. Ezra Klein famously articulated this dilemma as “the problem with everything-babel liberalism” and his bestselling collaboration with

Derek Thompson, “Abundance” has become part of the housing policy zeitgeist and helped inspire the YIMBY movement. Conservative “classical liberal” thought leaders like Tyler Cowen, Patrick Collison and others divine similar solutions focused on simplification (rather than deregulation) through “State Capacity Libertarianism.” Simplifying QAPs will make programs easier to administer and more productive and can go a long way toward increasing program efficiency.

Simplification and Streamlining

No matter where you are on the political spectrum, there is a growing consensus that this is the perfect moment to simplify housing policies and procedures. To that end, we must start to view LIHTC allocation policy through the lens of what is truly essential for the delivery of safe, sanitary, high-quality affordable housing and begin exploring how to pare back “nice-to-have” but not “essential” policies that drive up costs or slow down development. Our shared goal is to ensure affordable apartments are built quickly and at scale.

Affordable housing advocates often support leveraging and spreading resources among the greatest number of units, but sometimes these efforts result in the opposite of the intended effect. For example, scoring criteria that incentivizes securing U.S. Department of Housing and Urban Development (HUD) grants can have undesirable consequences. Subsidy layering increases timelines, legal and accounting costs and can often trigger policies like the National Environmental Policy Act, Davis-Bacon and Section 3, which further increase costs and design requirements that decrease production.

Large developments in markets that have high housing demand may serve needs better. Economies of scale achieved when developments exceed 200 units help

spread the fixed costs involved in bond transactions across a greater number of units and allow developers to leverage bulk purchasing opportunities and more efficient operations that can result in significant per unit savings and reduce the need for subordinate financing.

While sustainable, utility-efficient design and the use of quality durable building products are commendable, there can be diminishing returns to these investments, particularly when they are stacked. Today building codes have caught up with green and resilient building standards, making many design requirements in QAPs duplicative or generating excessive costs that are not in sync with the utility or carbon savings, especially when so many families are in need.

No Monopoly on Good Ideas

As I explored in my August article, we will need to adopt an “all of the above” strategy to get the affordable housing job done by blending funding resources, regulatory streamlining and cost-efficient design, technology and program administration. No doubt there are many other impactful strategies to be uncovered and the best way to do so is for policymakers to solicit feedback from their most productive development partners to further calibrate strategies and to maximize the potential of the 25% test. This can be enhanced or handicapped by the steps policymakers take as they reenvision the new 4% LIHTC program. ♦

Thom Amdur is senior vice president, policy and impact at Lincoln Avenue Communities (LAC), one of the nation's fastest-growing developers, investors and operators of affordable and workforce housing, providing high-quality, sustainable homes for lower- and moderate-income individuals, seniors and families nationwide. LAC is a mission-driven organization with a presence in 28 states and a portfolio of 170-plus properties comprising 30,500-plus units housing 80,000-plus resident.

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