INTRODUCTION TO THE LOW-INCOME HOUSING TAX CREDIT PROGRAM

Wisconsin Housing and Economic Development Authority **(WHEDA)** was appointed by the Governor to administer the IRS federal Low-Income Housing Tax Credit Program for Wisconsin. This brief introduction to the Program is intended to help readers understand Tax Credit basics. Detailed information about the application process, program requirements, and compliance regulations is available on our website, www.wheda.com.

#1 WHY WAS THE LOW-INCOME HOUSING TAX CREDIT CREATED?

Congress enacted Section 42 of the Internal Revenue Code as part of the Tax Reform Act of 1986. The Credit replaced traditional tax benefits eliminated on multifamily real estate. The program was created to encourage production of affordable multifamily rental housing for low-to-moderate income persons. Without the Credit, cash flow from rent is often inadequate to support housing development. Tax credits increase the owner/investor down payment in a housing development by lowering mortgage and financing costs allowing lower rents.

#2 WHAT IS THE LOW-INCOME HOUSING TAX CREDIT?

The Low-Income Housing Tax Credit is a dollar-for-dollar reduction of federal income taxes owed by owners/investors in qualified projects for tenants whose incomes are at or below 60% of County Median Income (CMI).

#3 WHO CAN USE THE CREDIT, AND HOW?

Owners/investors (corporations or individuals) reduce their federal income tax liability over a 10-year period in qualifying projects. The benefit is spread over 10 years and the investor equity contribution is lower than the cumulative Tax Credit. There are limitations on individuals claiming Credit on personal income taxes. ***Since the program is quite complicated, consultation with competent tax and legal counsel is strongly recommended.***

#4 HOW DO DEVELOPMENT OWNERS/INVESTORS OBTAIN CREDIT?

An application for Tax Credit must be submitted to WHEDA. Applicants must meet mandatory threshold requirements for financing, market, site control, and zoning. Applications are then evaluated and points are awarded for select criteria as outlined in WHEDA's current Qualified Allocation Plan.

#5 HOW DOES A HOUSING DEVELOPMENT QUALIFY FOR CREDIT?

To qualify for Credit, owners/investors must agree to maintain the project for 30 years with a minimum percentage of rent-restricted units for income-qualified tenants. If this does not occur, the IRS can "recapture" Credit retroactively.

Owners **must** choose one of the following options, known as the "minimum set-aside election":

> At minimum, 20% of the units must be rented to tenants with incomes not exceeding 50% County Median Income, adjusted for family size,
> ***OR***
> At minimum, 40% of the units must be rented to tenants with incomes not exceeding 60% of County Median Income, adjusted for family size.

There are two components required to qualify a set-aside unit. The first is the **rent** and the second is the **income** of the tenant(s). **Maximum rent** of set-aside units, including utilities, is based on a 1.5 person per bedroom calculation. The **maximum income** of tenants cannot exceed 50% or 60% of County Median Income (**CMI)**, based on actual family size. Rent and Income Limits are available on www.wheda.com.

#6 HOW DOES THE SET-ASIDE AFFECT THE AMOUNT OF CREDIT A DEVELOPMENT RECEIVES?

Only the actual percentage of total units set-aside is used in the Tax Credit calculation. Owners may choose to set-aside any percentage of units between the minimum and 100%. For example, if an owner chooses to set-aside 20% of the units at 50% of CMI, only 20% of depreciable development costs are utilized in the Tax Credit calculation. If the owner chooses to set-aside 40% of units for tenants with incomes at 60% of CMI, only 40% of depreciable development costs are used in the Tax Credit calculation. If the owner chooses to set-aside more than the minimum percentage of units, whatever percentage is chosen at either 50% or 60% of CMI will determine the Tax Credit calculation.

#7 IS A TAX CREDIT DEVELOPMENT AUTOMATICALLY A GOOD INVESTMENT?

Not necessarily. Tax Credits provide additional equity needed to reduce the amount of financing to a level at which rents will support development operating expense and debt service. Risks exist on Tax Credit developments, which investors or lenders must consider, as they would for any other rental real estate investment. As with other multifamily development, issues such as market, management, location, quality of construction, and credibility and experience of the developer must be carefully assessed. In addition, it is important for owners/investors to know that failure to comply with IRS program requirements could lead to recapture of the Credit by the IRS jeopardizing the housing development.

#8 IS THE LOW-INCOME HOUSING TAX CREDIT PROGRAM WORTH THE EFFORT?

Yes! Although the tax credit program is complex, it has considerable benefits.

- **Limited-income persons** have access to affordable housing.
- **Owners/Investors** receive the benefit of the dollar-for-dollar offset against their federal income tax liability for 10 years.
- **Lenders** loan-to-value is decreased by Tax Credit equity.
- **Jobs** are created by the production of housing.
- **Communities,** especially rural and economically-stressed urban communities, receive the benefit of housing which will be affordable to their citizenry for 30 years.