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THE QUALIFIED ALLOCATION PLAN (QAP) *A Potential Tool in the Affordable Housing Preservation Toolbox*

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The Qualified Allocation Plan (QAP): ***A Potential Tool in the Affordable Housing Preservation Toolbox***

The federal Low Income Housing Tax Credit program (LIHTC) is a major resource for the creation and rehabilitation of housing affordable to lower income households. Although housing tax credits are federal, each state has an independent agency (generally called a housing finance agency, or HFA) that decides how to allocate their share of federal housing tax credits. Each HFA must have a QAP, a “qualified allocation plan,” which sets out the state’s priorities and eligibility criteria for awarding federal tax credits (as well as tax-exempt bonds and any state-level tax credits) to housing projects.

The QAP is a tool advocates can use to influence how their state’s share of annual tax credits is allocated to affordable housing projects. Advocates can use the public hearing and comment requirements to convince their HFA to better target tax credits to projects that preserve the existing stock of affordable housing.

This guide presents a sketch of the federal requirements pertaining to QAPs, along with advocacy hints. A brief, general description of the LIHTC program is also included after the QAP presentation.

What is the QAP?

The QAP (qualified allocation plan) is a document that state (and a few local) agencies must have in order to distribute federal housing tax credits, which can only be awarded to a building that fits the QAP’s priorities and criteria.

Each QAP must:

- Spell out an HFA’s priorities and specify the criteria it will use to select projects competing for tax credits. The priorities must be appropriate to local conditions.
- Give preference to projects:
 - Serving the lowest income residents.
 - Serving income-eligible residents for the longest period of time.
 - Located in “qualified census tracts” (QCTs), which are tracts with a poverty rate below 25% or in which 50% of the households have incomes below 60% of the area median income (AMI).

The selection criteria must address eight items. One selection criteria is key to this discussion of preserving affordable housing: project characteristics, “including whether a project includes the use of existing housing as part of a community revitalization plan.” The other items are: location, housing needs, public housing waiting lists, individuals with children, special needs populations, project sponsor characteristics, and projects intended for eventual tenant ownership.

Advocacy Ideas For Targeting Your QAP To Preserve Affordable Housing

The above requirements are minimums; states can adopt more rigorous criteria that favor the preservation of existing federally-assisted and other affordable housing. Because each state gets a new allocation of federal tax credits each year, QAPs are usually drafted annually. This gives advocates regularly scheduled opportunities to influence QAP priorities. And, because there is generally a lot of competition among developers to win tax credits, they will propose projects that give them an advantage in the selection process set out according to the QAP's priorities.

Improving the Priorities and Selection Criteria

HFAs can target tax credits several ways:

- The QAP selection process can give preferences (in the form of extra points) to encourage developers to submit preservation-oriented projects.
- The QAP can establish a set-aside, reserving a specific percentage or dollar amount of any given year's tax credit allocation for preservation-oriented projects.
- The QAP can establish thresholds, minimum requirements that projects must meet simply to get in the game. This seems to have limited applicability for preserving housing, but can be used with new projects to improve targeting to extremely low income people or ensure longer availability to low income people.

⇒ Advocates can work to ensure that the preservation of existing, federally-assisted housing is clearly stated as a high priority.

→ Recall that QAP selection criteria must address project characteristics, "including whether a project includes the use of existing housing as part of a community revitalization plan."

→ If the QAP only has a general statement of goals, work to get very specific set-asides or preference points for preservation. Some states only have very general goals; these are ripe for efforts to introduce set-asides and extra points for preservation.

→ If the QAP has too many "priorities," effectively rendering preservation one of many worthy efforts, work to narrow the number of priorities or work to establish relative priorities so that preservation can compete more effectively.

➤ For example, one state lists nine general goals, only one of which is "To prevent the loss from the existing stock of low income rental housing of those units under expiring contracts with federal agencies or subject to prepayment which, with the allocation of tax credits, would be converted to market rate units."

→ If there are types of assisted-housing that should be at the top of the priority list, for example units with more than two bedrooms, work to ensure that they are positioned to better compete.

→ If the QAP does give some priority to preservation projects, does it cover all of the types of housing at risk of losing a federally-required "use restriction" (limited rent levels and occupancy by lower income people)? What types of

affordable housing at risk are most important to you and should therefore have the greatest priority?

- A QAP might merely offer bonus points to existing tax credit projects that are approaching the end of their use restriction period, or to prevent foreclosure of federally-assisted projects. Advocates might want to be sure other types of situations and subsidies are included, such as: expiring subsidized FHA-insured mortgages; expiring Section 8 contracts; expiring HOME affordability periods; expiring Rural Development Section 515 mortgages; or, Section 515 projects in danger of “prepaying” the mortgage and leaving the program.
- Some limit tax credit priorities to projects with expiring use restrictions in the current year; if this is not enough time, advocates might want to open up the window of opportunity to include projects that will be at risk in two, three, or five years.
- A couple of states do have set-asides for projects assisted with USDA’s Rural Development programs, but do not offer set asides for HUD-assisted programs.

- ⇒ Can rural projects get fair access to tax credits? Ohio devotes 20% of its preservation set-aside to rural projects.
- ⇒ Is it important to emphasize large or small projects? West Virginia gives 10 more points to projects with fewer than 50 units.
- ⇒ Advocates should review the QAP to find out how long low income units must serve lower income people (see “Lower Income Occupancy Period” on page 7 of this guide). If it is only the basic 15 years, plus extended use period of another 15 years:
 - Try to get the “compliance period” lengthened as a threshold issue (Maine has a 90-year threshold); or,
 - Try to get bonus point preferences or set-asides for projects that voluntarily agree to a longer compliance period. (Michigan has a 30% preservation set-aside, which requires assisted projects to remain affordable for an additional 30 years.)
 - Try to get preferences for projects in which the owner agrees at the outset not to convert the building to market rate after the first 15 years. (Maryland gives 5 points to a project if the owner agrees not to exercise the right to any opt out rights and takes on a 40-year rent-restricted period.)
- ⇒ If current practice limits access to preservation projects, relative to need, work to modify or eliminate the practice. For instance, if tax credits are allocated “equally” in a way that distributes them geographically throughout the state, preservation projects might be unduly denied tax credits if most are concentrated in particular geographic areas.

- ⇒ If current criteria put preservation-oriented projects at a disadvantage, work to have them modified or removed entirely. For example, some states award more points for projects with more bedrooms or in-unit laundry equipment – good features for families, but features which place rehab at a disadvantage. Therefore, advocates in such situations should seek separate point systems for new construction and rehabilitation.
- ⇒ Some states give priority to environmentally sound (“green”) projects – again, a very good feature, but one that can place rehab at a disadvantage to new construction. Advocates should work to ensure that the QAP acknowledges rehab as inherently “green,” and that “green” preference features are appropriately tailored for new construction and rehab projects.

Procedural Handles for Improving the QAP

There must be a public hearing about a proposed QAP before it is approved by the unit of government overseeing the HFA. The law and regulations do not provide any more guidance regarding the public hearing. Although not required in federal law or regulation, most states also require a public review and comment period for a proposed QAP.

- ⇒ Advocates should contact the HFA early to learn about its annual QAP process and build this into the work plan for the year.
- ⇒ Advocates should be sure to get on any notification list the HFA might have about the QAP and public hearing.
 - Is there adequate advance notice?
 - Is the draft QAP available to the public in enough time to analyze it?
 - Are multiple hearings in different parts of the state warranted?
 - Is it possible for advocates to submit written comments?

Once an HFA has decided to award tax credits to a building, it must notify the chief executive officer (e.g., mayor, county executive) of the local jurisdiction where the building is located. That CEO must have a reasonable opportunity to comment on the project.

- ⇒ Advocates should ask the Executive’s office and any relevant “housing” department at the locality to notify them as soon as the HFA contacts the Executive about a proposed project. (Advocates might also seek an HFA policy that notifies interested parties at the same time the CEO is notified, just in case the local officials are not cooperative.)
- ⇒ Advocates should seek a local policy requiring public notice and comment, along with public hearings, about a proposed project.

There must be a comprehensive market study of the housing needs of low income people in the area to be served by a project before tax credits are allocated. The project developer must hire a disinterested, third party approved by the HFA to conduct the market study.

- ⇒ Advocates should be aware of this requirement but need not get too distracted by it. If it seems critical and if advocates have the resources, in some problematic circumstances it might be helpful to assess the market study based on knowledge of the community (if necessary, seek technical help from a local university, legal services, or friendly community development corporation) and submit written or verbal challenges to aspects of the market study you disagree with.

If a building that does not fit the QAP's priorities is to get tax credits, the HFA must provide a written explanation and make it available to the public.

- ⇒ Advocates should be on the lookout for any such written explanation, or the failure to complete one.
- ⇒ If it is too late to reverse a decision you disagree with, use the critique of the written explanation as an example of a project to avoid when helping to shape next year's QAP.

Other advocacy ideas include:

- ⇒ Find out who is on the governing board and staff of the HFA and get to know them so that you can communicate your priorities throughout the year. Build relationships with the HFA staff and be in touch with them frequently.
- ⇒ Be sure to get added to any relevant listservs.
- ⇒ Be sure to get invited to any stakeholder meetings or focus groups.
- ⇒ Monitor the HFA's web site.
- ⇒ Don't wait for the formal QAP comment period or public hearing. Use relationships built with HFA staff to weigh in long before a draft QAP is formally announced for comment.
- ⇒ Encourage the Governor and state representatives and senators to emphasize preservation so that the HFA staff hear that "political" message and respond.
- ⇒ Contact Tracy Kaufman at the National Housing Trust who follows the QAP practices of HFAs. She can help identify HFA's allocation cycles, suggest key HFA staff to contact, and provide sample comment letters.
202.333.8931 x 29, or tkaufman@nhtinc.org; www.nhtinc.org.

For More Information

- HUD's HOME Program web site has links to a firm which lists the HFAs in all states at <http://www.novoco.com/stcaa.shtml>
- That HOME Program link also is a source of state QAPs at www.novoco.com/QAP.shtml#2006.
- A capsule description of the preservation-oriented features of each state's QAP is available from the National Housing Trust at www.nhtinc.org/documents/Pres_Scan_May2006_final.pdf.

The Low Income Housing Tax Credit Program (LIHTC): Background Information

The Low Income Housing Tax Credit program encourages private individuals and corporations to invest cash in housing affordable to lower income people by providing a tax credit to investors – a dollar-for-dollar reduction in federal taxes they owe on other income. The cash investors put up (called “equity”) is used along with other resources (tax credits are not meant to provide 100% financing) to build new affordable housing or to make substantial repairs to existing affordable housing. The infusion of equity reduces the amount of money a developer has to borrow and pay interest on, thereby reducing the level of rent that needs to be charged.

LIHTC is not a HUD program; rather, it is administered by the Treasury Department’s Internal Revenue Service (IRS). LIHTC was created by the Tax Reform Act of 1986 and is codified at Section 42 of the Internal Revenue Code [26 USC 42], so tax credit projects are sometimes referred to as “Section 42 Projects.” Unlike many HUD programs, the tax credit regs (26 CFR 1.42) are not extensive, and there aren’t numerous handbooks. IRS provides additional guidance through revenue rulings, notices, and private letter rulings.

Tax Credit Units

When applying to a state Housing Finance Agency (HFA) for tax credits, a developer has two unit set-aside options, and must stick with the chosen option during a required lower income occupancy period (see below). The two unit set-aside choices are:

- Ensuring that at least 20% of the units are “rent-restricted” (see next topic) and occupied by households with income below 50% of the area median income (AMI).
- Ensuring that at least 40% of the units are “rent-restricted” and occupied by households with income below 60% AMI.

Tax credits are available only for rental units that meet one of the above criteria. With these minimums, therefore, it is possible for LIHTC projects to have a mix of units occupied by lower income people and moderate and middle income people. Remember, these are minimums; projects can have higher percentages of rent-restricted units occupied by lower income people – even 100%. In fact, the more rent-restricted lower income units in a project, the greater the amount of tax credits provided (see page 8). Some HFAs choose to create deeper targeting in order to serve households with even lower incomes. For example, one state requires preservation set-aside projects to rent-restrict 10% of the units for households with incomes below 30% AMI and another 10% of the units for those with incomes below 40% AMI.

(HUD calculates 50% AMI, adjusts it each year, and posts it on the web at <http://www.huduser.org/datasets/il/il06/index.html>. That web site does not, however, have 60% AMI figures. For reasons of arithmetic, HUD recommends multiplying the 50% AMI figure by 120%.)

Tax Credit Rents

“Rent-restricted” units in a LIHTC project have maximum gross rents (including allowance for utilities) that are less than 30% of “imputed” lower income; that is, the rent charged to a hypothetical tenant paying 30% of either 50% AMI or 60% AMI, whichever option the developer chose.

Tenants pay that fixed maximum tax credit rent even if it is greater than 30% of their income. In other words, the rent a tenant pays is not based on 30% of the tenant’s income; rather it is based on 30% of the fixed AMI level. Consequently, lower income residents of tax credit projects might be “rent burdened” – paying more than 30% of their income for rent and utilities. Or, tax credit projects might simply not be financially available to very low and extremely low income people because rents charged are not affordable to them. HUD’s tenant-based Housing Choice Vouchers or Project-based Section 8 vouchers, or USDA Rural Development Section 521 Rental Assistance (RA) are often needed to fill the gap between 30% of a resident’s actual income and the tax credit rent.

(Actually, the calculation of tax credit rents is more complicated because it is based on an “imputed” number of 1.5 people per bedroom and the number of bedrooms in a unit. See Question 10 at “Frequently Asked Questions” on the “Income Limits” page of the “Data Sets” page of the “HUD User” web site, www.huduser.org/datasets/il/il06/faq.html.)

Lower Income Occupancy Period

The law requires units to be rent-restricted and occupied by income-eligible households for at least 15 years, with an “extended low income housing commitment” for another 15 years (30 years all together). This 30-year period is called the “compliance period.” Some states require periods greater than 30 years or provide incentives for projects that voluntarily agree to longer periods. Where states do not mandate longer restricted-use periods, during the 14th year of the first 15-year period an owner can submit a request to the HFA to sell a project or convert it to market rate. The HFA has one year to find a buyer willing to maintain the rent restrictions for the balance of the 30-year period. If the property can’t be sold to such a “preservation purchaser” then the owner’s obligation to maintain rent-restricted units is removed and lower income tenants receive enhanced vouchers enabling them to remain in their units for three years.

HFAs must monitor projects for compliance with the income and rent restriction requirements. IRS can recapture tax credits if a project fails to comply, or if there are housing code or fair housing violations.

How Tax Credits Work

The LIHTC program is very complicated and is dependent upon an array of technical specialists. What follows is a very simplified summary of how tax credits work.

State Credit Ceilings

Each year states can allocate new tax credits up to their “credit ceiling” which is based on population and an annual inflation factor. For FY06 the credit ceiling was \$1.90 per capita. Developers apply to an HFA and compete for tax credit allocations. A state’s criteria for awarding tax credits are spelled out in its annual Qualified Allocation Plan (QAP). The law requires that a minimum of 10% of an HFA’s total tax credits be set aside for nonprofits.

Limited Partnerships

Once awarded tax credits, a developer then sells them to investors, usually to a group of investors pulled together by someone called a “syndicator.” The cash (equity) that the investors put up is used by the developer, along with other resources such as conventional mortgages and state loans, to construct new affordable housing or to substantially rehab affordable housing.

The developer and investors form a “limited partnership” in which the developer is the “general partner” and the investors are “limited partners.” The general partner owns very little of the project (maybe as little as 1%) yet has a very active role in construction or rehab and day-to-day operation of the completed project. The limited partners own most of the project (maybe up to 99%) but play a passive role; they are involved only to take advantage of the reduction in their annual tax obligations.

9% credits and 4% credits

You will hear the terms “9% credits” and “4% credits,” formally known as the “applicable percentages.”

The 9% tax credit is available for new construction and substantial rehab projects that do not have other “federal funds.”

- “Federal funds” include loans and bonds with below market-rate interest. A HOME Program loan with an interest rate below the Treasury rate (known as the “Applicable Federal Rate” or AFR) would be considered “federal funds,” but a HOME loan at the AFR would not be considered “federal funds.”
- Rehab is “substantial” if an average of \$3,000 per rent-restricted lower income unit is spent or if 10% is spent on the “eligible basis” (see next subsection) – whichever is greater – during a 24-month period.

The 4% tax credit is available for three types of activities:

- 1) Acquisition of existing buildings (for substantial rehab).
- 2) New construction or substantial rehab subsidized with other “federal funds.”
- 3) Projects financed with tax-exempt bonds. (Every year, states are allowed to issue a set amount, known as the “volume cap,” of tax-exempt bonds for a variety of economic development purposes.)

Projects can combine 9% and 4% tax credits. For example, buildings can be bought with 4% tax credits and then substantially rehabbed with 9% tax credits.

The figures 9% and 4% are only approximate rates. Actual rates are computed monthly by the IRS based on U.S. Treasury Department interest rates. For any given project, the real tax credit rate is set the month a binding commitment is made between an HFA and developer, or the month a finished project is first occupied (“placed in service”). The developer chooses. This “applicable percentage” is used to determine the investors’ tax credit each year for ten years (the “credit period”).

(Instead of 9% and 4%, you might hear about a tax credit rate which yields a 70% or 30% “net present value.” This is just another way of saying, in the case of a 9% credit, that the stream of tax credits over the 10-year credit period has a value today equal to 70% of the eligible development costs.)

Determining the Amount of Tax Credits

The amount of tax credits a project can receive, and therefore how much equity it can attract, depends on a several factors.

First, the “**eligible basis**” must be determined. The IRS specifies which costs are eligible (“eligible basis”) for the tax credit. “Depreciable” costs are eligible, including building acquisition, construction, soil tests, utility hookups, and engineering costs. Land acquisition and permanent financing costs are not counted toward the eligible basis. And, the eligible basis is usually reduced by the amount of any “federal funds.”

The eligible basis of a project can get a 30% increase (a “basis boost”) if the project is located in a census tract designated by HUD as a low income tract (“Qualified Census Tract” or QCT) or a high cost area (“Difficult to Develop Area” or DDA). QCTs and DDAs are posted at www.huduser.org/datasets/qct.html.

Second, the “**applicable fraction**” must be determined. This is a measure of rent-restricted lower income units in a project. There are two possible percentages: the ratio of lower income units to all units (the “unit fraction”), or the ratio of square feet in the lower income units to the project’s total square feet (the “floor space fraction”). The lowest percentage is the applicable fraction.

The applicable fraction agreed to by the developer and IRS at the time a building is “placed in service” (first occupied) is the minimum that must be maintained during the entire affordability period (“compliance period”).

The greater the proportion of rent-restricted lower income units in a project (the greater the applicable fraction), the more tax credits a project can receive. This is an incentive to create projects with more than the minimum number of required rent-restricted lower income units (20% of the units if the target maximum income is 50% AMI, 40% of the units if the target maximum income is 60% AMI).

The “**qualified basis**” is the eligible basis times the applicable fraction.

The amount of **annual tax credits** a project can get is the qualified basis times the tax credit rate (9% or 4%). The amount of tax credits available to a project is divided among the limited partners based on each limited partner's share of the equity investment. Investors receive their share of the tax credit each year for ten years (the "credit period").

A Simple Example

HUD's HOME Program web site has a simple example that brings it all together:

Project will construct 70 units, 40% of them are income and rent restricted.
There are no other federal funds.

Total development costs	\$5,000,000
Land acquisition	\$1,000,000
Construction	\$3,400,000
Site Improvements	\$ 535,000
Engineering	\$ 40,000
Eligible Soft Costs	\$ 25,000

Eligible Basis: Total Development Cost – Land Acquisition = \$4,000,000

Qualified Basis: Eligible Basis x Applicable Fraction ($\$4,000,000 \times .40$) = \$1,600,000

Annual Tax Credit: Qualified Basis x Tax Credit Rate ($\$1,600,000 \times .09$) = \$144,000

Total Amount of Tax Credits: $\$144,000 \times 10$ years = \$1,440,000

The example continues, noting that a limited partnership will buy the tax credits at \$0.75 for every dollar of future tax benefit (the tax credit "price"). Thus the limited partnership will invest \$1,080,000 ($\$1,440,000 \times .75$) in the project today for a ten-year stream of future tax benefits amounting to \$1,440,000.

For More Information

- A good and easy to read summary is available from the Technical Assistance Collaborative (TAC). It is a special edition of its publication, *Opening Doors*, Issue 26, April 2005, “Using the Low Income Housing Tax Credit Program to Create Affordable Housing for People with Disabilities.” Go to <http://www.tacinc.org/Pubs/ODpubs.htm>.
- HUD’s HOME Program web page has a good, basic tutorial at <http://www.hud.gov/offices/cpd/affordablehousing/training/web/lihtc/>.
- The Housing Assistance Council (HAC) has three resources:
 - A guidebook called *Utilizing the Low Income Housing Tax Credit for Rural Rental Projects*. Chapter III, “Tax Credit Basics,” is a good overview at www.ruralhome.org/pubs/guides/lihtc/toc.htm.
 - The Winter 2003-2004 edition of *Rural Voices* is devoted to “Tax Credits and Rural Housing” at www.ruralhome.org/manager/uploads/VoicesWinter0304.pdf.
 - A short one page overview is available at www.ruralhome.org/infoSheets.php?id=177.
- The National Housing Trust lists LIHTC projects on a state-by-state basis at www.nhtinc.org/data_map.asp.
- The Enterprise Foundation has two resources:
 - *Tax Credits 101*, a tutorial at www.enterprisecommunity.com/industryTaxCredit/TaxCredits.html
 - A shorter, “Guide to the LIHTC” at www.enterprisecommunity.com/industryTaxCredit/guidetoLIHTC.html.
- A good two-page overview is available from Joe Guggenheim’s web page, www.housingtaxcredits.net/housing_tax_credits_description.html
- Subscribers to *Housing Development Reporter* can get a good overview from Chapter 26 of its Reference File.
- HUD’s data base of LIHTC projects, updated through 2003, is at www.huduser.org/datasets/lihtc.html.