Prospect of Tax Reform Upends Affordable Housing Finance

By Kristin Broughton, American Banker, January 12, 2017

The mere whiff of corporate tax reform is said to be causing delays in bank-backed financing for low-income housing projects amid a severe U.S. shortage of affordable units.

Investments by banks in housing developments have hit snags in the two months since Republicans swept the elections, according to bankers, auditors and affordable-housing advocates.

The sense that tax reform is within reach for the first time in decades "immediately slowed things down," said Rob Likes, national manager for community development at KeyBank. "We're hearing about that from our clients and from the market."

What's the connection? The affordable housing market relies heavily on subsidies through the low-income housing tax credit program. Developers use the credits to fund as much as 70% of the cost of new housing projects. Banks make equity investments in the projects by buying the tax credits and in return claim a range of tax benefits over a 10-year period.

"Different banks are approaching this differently," said Buzz Roberts, CEO of the National Association of Affordable Housing Lenders, whose members include several large and regional banks.

Some banks have taken a “bit of a pause” on making new investments, Roberts said, describing it as a “prudent” move as banks wait for clarity on corporate rates (and thus potential tax savings) drop. Such decisions leave last-minute gaps in financial plans that have taken years to finalize, observers said.

Banks walked away from affordable housing projects in "a few cases" last month, said Fred Copeman, a partner with the accounting firm CohnReznick who focuses on tax investments.

"There has been some market dislocation," Copeman said, though he declined to provide specifics. He expects the pace of new deals in the $14 billion market to slow down in the first few months of 2017 and then pick up again whenever the market has a better sense of where tax reform is heading.

Evidence about the funding delays for affordable housing projects is mostly anecdotal at this point. Copeman, for instance, described an affordable housing deal in Virginia that was delayed a few weeks ago because the bank — which he declined to name — told the developer to restructure its offer. The project now faces a $1 million shortfall.
Still, the delays illustrate the awkward situation many banks — especially big banks — face as they plan for decade-long investments in tax-credit programs amid the

uncertainty about future tax rates. Moreover, the situation provides a glimpse of how incentives may changes for banks to invest in social programs — such as affordable housing or renewable energy –as the tax reform debate taxes shape.

President-elect Donald Trump and Republican leaders in Congress have made tax reform a priority in the coming year.

Trump promised on the campaign trail to lower the corporate rate to 15% from its current level of 35%. Meanwhile, House Republicans last year proposed a 20% corporate rate as well as the elimination of special credits.

Bankers and housing advocates said they feel confident that the low-income housing credit will remain intact. Most noted bipartisan support for the program. A House Ways and Means Committee staffer has sought to reassure the affordable housing community that the program won't be on the chopping block, Copeman said.

It's possible that lawmakers may also expand the low-income housing tax credit program as part of a tax overhaul, observers said.

But the legislative process is, of course, messy. And with Congress facing a packed schedule, it's hard to tell how long it will take before banks — the primary investors in the affordable housing market — have clarity.

"The probability of [Congress scaling it back the low-income housing credit] goes up if people take it for granted," said Michael Novogradac, managing partner at the accounting firm Novogradac & Co., who is also a member of the Affordable Housing Tax Credit Coalition. "A strong advocacy effort is underway."

To better understand why some banks are temporarily pulling back from the market, consider this scenario.

Say that an affordable housing developer receives an allocation of $10 million in low-income credits. Banks bid against each other to invest in the credits, with the goal of lowering their tax liability and possibly receiving credit on their Community Reinvestment Act exams.

Under the hypothetical scenario, a big bank tells the developer that it will invest $10 million in the housing project, or pay $1 per credit.

But as the corporate tax rate falls, the value of the tax benefits fall, as well. To keep the yield on its investment steady, the bank tells the developer that it plans to invest less in the housing project.

According to estimates from Novogradac, lowering the tax rate to 25% would lower the price per credit to 89 cents. In the scenario above, the bank would invest $8.9 million in the affordable housing project, or $1.1 million less than originally planned.

Also contributing to delays in getting projects off the ground has been an increase in the rates on commercial mortgages since the election, KeyBank's Likes said.

Likes added that Key has honored the pricing it promised to developers before the November elections. The $135 billion-asset bank has, however, started underwriting new deals assuming a 25% tax rate, he said.

Others are making course corrections, too.

"We are looking at each investment we will make in 2017 in the context of potential tax reform, which has meant some adjustments to our assumptions," said Beth Stohr, senior vice president of low-income housing tax credit production at the $448 billion-asset U.S. Bancorp in Minneapolis, in an email.

Most observers say that the pullback will be temporary as banks wait for clarity from Congress. Still, if uncertainty about tax reform drags on, it's likely that rent-burdened households will have the most to lose.

Demand for affordable housing has spiked upward in the past decade, especially in cities such as Los Angeles and Miami, where supply is low and the cost of living is soaring.

Meanwhile, affordable housing is getting harder to come by for families in need. Across the country, cities are losing about 300,000 units per year as units convert to market pricing, according to the Department of Housing and Urban Development.

The low-income housing tax credit — established during the last tax reform effort, in 1986 — is the primary tool that policymakers have to add to the stock of affordable housing, said Chris Herbert, head of the Joint Center for Housing Studies at Harvard University.

Over the past 20 years, it has added an average of 107,000 affordable units to the market per year, according to HUD.

"Its track record of success is pretty remarkable, and it relates to the fact that, if you have private investors on the hook, this creates some discipline," Herbert said.

Still, as banks wait for clarity from Congress on the details of a tax reform bill, some are scaling back their presence in the market, at least for the time being.

"This is an unusual situation," Roberts said. "We haven't really seen a moment where tax reform seemed this likely in quite a number of years."