

**CALIFORNIA TAX CREDIT ALLOCATION COMMITTEE**

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DATE: July 8, 2008  
 TO: Tax Credit Allocation Committee Members  
 FROM: William J. Pavão, Executive Director  
 SUBJECT: Contingency Planning for Additional Federal Resources and Discretion

The United States Senate is currently considering legislation (H.R. 3221) that would amend the Low Income Housing Tax Credit (LIHTC) program in several ways. Two changes would require the California Tax Credit Allocation Committee (TCAC) to promptly decide an appropriate allocation policy for the second round. The first change would make available another \$0.20 in LIHTCs per capita to California in 2008 (approximately \$7.3 million in annual federal credit) and again in 2009. The second change would permit the State to allow boosts of up to 30 percent (30%) to eligible basis for projects not currently permitted such a boost under federal law.

### **Additional Credit in 2008**

**Background:** TCAC regulation Section 10315(h) establishes the “Supplemental Set-Aside” which initially receives three percent (3%) of the federal credit ceiling as of February first each year. Thereafter, the supplemental set-aside receives returned credits and any unused credits from the various other set-asides and apportionments. Supplemental set-aside credits fully fund projects where set-asides or apportionments lack adequate remaining credits.

In addition, supplemental set-aside credits fund waiting list projects following round 2 each year. Section 10310(b)(3) specifies that “waiting list” tax credits include returned credits and “national pool” credits received during the year from the IRS. Finally, Section 10325(h), in describing the 9% credit waiting list, includes tax credits “that may have been returned to the Committee.”

The initial set-aside amounts and geographic apportionments are established as of February first of each year, by regulation (Section 10315(a) – (h)). Only the supplemental set-aside may receive unused or returned credits, or national pool credits which typically arrive each October or November.

**Analysis:** The regulations do not anticipate a significant unexpected federal augmentation of LIHTCs in mid-year. The regulations state that any returned or additional credits, such as national pool credits, simply land in the supplemental set-aside and permit the Committee to fund further down the second round waiting list.

Awards from the supplemental set-aside would not invoke regulation Section 10325(d), which states that “all Credits drawn from the Supplemental Set Aside will be deducted from the Apportionment in the subsequent round.” In the past, this provision has caused consternation among the geographic regions when large supplemental set-aside awards are deducted from the next year’s apportionment. However, last year TCAC administratively determined that this provision applies only to current year credits awarded out of the supplemental set-aside. That is, the round-to-round debiting and crediting is meant to account for current year credit surpluses and over-allocations. Prior-year returned credits and national pool augmentations are not factored into the round-to-round accounting.

The Committee could elect to amend regulations and cascade the credits through the set-asides and apportionments to accommodate this one-time special circumstance. This would spread the credits among the various priority set-asides and regions. However, a 10 percent increase within each set-aside and region would be unlikely to significantly affect regional outcomes. For example, every region other than Los Angeles County has less than \$3 million in total credit available to it in round 2. Therefore, each region would get less than \$300,000 in additional credit, which is less than half of the average award. Therefore, the affect within the regions generally would be minimal.

Another alternative would be to conduct a third funding round, perhaps for a subset of project types. This option would be very labor- and time-intensive for little additional public benefit. Selecting a subset of potential applications, such as special needs or homeless assistance projects, could result in weaker projects receiving funding than would occur otherwise in a wider competition.

**Recommendation:** Place any additional 2008 credit authority into the supplemental set-aside to fund additional waiting list projects. Recent experience has been that the waiting lists contain extremely strong applications, typically receiving full points with strong tiebreakers. This would be the most efficient and fair practice short of a regulation change for these special circumstances. The additional credits for 2009 will be reflected in the initial set-asides and apportionments since those credits will be available by February 1, 2009.

### **Eligible Basis Increases Outside of Federally-Designated Areas**

**Background:** Under federal law (IRC Section 42(d)(5)(C)) a project located within a federally-designated Difficult to Develop Area (DDA) or Qualified Census Tract (QCT) may claim 130 percent (130%) of the project’s basis for purposes of calculating the project’s federal credits. This basis boost was meant to provide additional equity to projects in high-cost or impoverished areas.

The pending federal legislation would allow the State to designate other project types or areas for such a boost.

**Analysis:** California state law (Revenue and Taxation Code Sections 12205, 17058, and 23610.4 et. seq.) created a state low income housing tax credit to complement the federal credit. By statute, the state credits were intended to provide additional equity to projects that could not claim 130% of a project’s basis under federal law. In essence, the California State credits were intended to help non-DDA/QCT projects with additional credits.

The proposed federal authority would, as a practical matter, supplant a state resource that is available in ample supply. Committing additional federal credit per project under the proposed authority could reduce the number of projects receiving federal credits while leaving ample State credits untapped.

**Recommendation:** Continue to rely upon federally-designated DDAs and QCTs for purposes of accessing the federal 130% basis boost. Non-DDA/QCT areas may continue to apply for and access State credits to attract in additional equity. Staff will engage the stakeholder community in a dialog as to whether circumstances would ever warrant permitting a federal credit boost in addition to a State credit award. Such a combination may require a State statutory change.