Low Income Housing Tax Credit overview

The Low Income Housing Tax Credit (LIHTC) is a federal program that encourages private investment in affordable rental housing by providing a dollar-for-dollar reduction in federal income tax liability in exchange for investment in qualifying new construction and rehabilitation projects.

The tax credit comes in two amounts: 9 percent credits, which are awarded on a competitive basis and are generally used in new construction and larger renovation projects, and 4 percent credits, which are worth about half as much as the 9 percent credits and generally used either for the rehabilitation of existing structures or for simpler new construction projects. The 4 percent credits are available as of right to projects funded with multifamily housing bonds—a type of tax-exempt private activity bonds—and so are not competitive in and of themselves. However, there is a maximum cap for all private activity bonds issued by a state each year, and in states that are at or near their cap there may be a shortage of bond authority that can lead to limitations on developers’ ability to access multifamily housing bond financing. Local and state housing finance agencies evaluate the projects applying for tax credits against criteria laid out in their Qualified Allocation Plan, a document that is prepared annually and describes priorities for how the tax credit will be used in the coming year. Projects using both 9 percent and 4 percent credits must also meet financial feasibility requirements. In most states, there is strong competition for 9 percent credits such that not all applicants receive funding.

Once tax credits have been awarded, they are usually sold and converted into equity through a process called syndication. The equity generated through the syndication proceeds is used to subsidize the development, helping to make the creation of below-market rate rentals possible. Additional funding (beyond the tax credit equity and the debt raised based on the projected rent revenue stream) is often needed to close the gap between available funds and the project’s cost.

While LIHTCs are generally awarded at the state level by state housing finance agencies, they are an essential resource for the production of affordable rental housing and thus an important policy for local governments to be aware of and to utilize. Relevant roles for local governments include advocating for changes in the state Qualified Allocation Plan to ensure it advances key policy priorities, and providing local gap funding to help proposed LIHTC projects be financially viable and/or qualify for a high priority for a LIHTC award. In addition, in some communities, credits are allocated directly by a local housing finance agency in addition to a state agency.
This section focuses on the competitive 9 percent tax credit. Click here to learn about 4 percent credits, which are awarded in conjunction with multifamily private-activity bond financing.