NCSHA

Leveraging Fiscal Recovery Funds with the Housing Credit: *Why We Need the LIFELINE Act*

What is the Coronavirus State and Local Fiscal Recovery Fund?

The Coronavirus State and Local Fiscal Recovery Fund (FRF), authorized in the American Rescue Plan Act (ARPA) in March 2021, provides $350 billion to state, local, territorial and tribal governments to support their response to and recovery from the Covid-19 public health emergency.

How can the funds be used?

By statute, governmental entities receiving FRF may use these funds in four broad categories: to replace lost public-sector revenue; to respond to the far-reaching public health and negative economic impacts of the pandemic; to provide premium pay for essential workers; and to invest in water, sewer, and broadband infrastructure. The program provides flexibility for jurisdictions to meet local needs within these four eligible use categories.

Can FRF be used for affordable housing?

Yes, but as discussed below, there are significant challenges to using these funds for certain affordable housing activities. The FRF final rule issued by the Treasury Department in January 2022 clarifies that recipients may use the funds for various affordable housing uses, all of which fall under the larger category of responding to public health and negative economic impacts of the pandemic. Eligible affordable housing activities include the development of affordable housing and permanent supportive housing, rental assistance, mortgage and down payment assistance, assistance with delinquent property taxes, and more.

Are there challenges to using FRF to build and preserve affordable rental housing?

Nearly all affordable rental housing built and preserved today relies heavily on Low Income Housing Tax Credit (Housing Credit) equity. But Housing Credit equity alone typically is not enough to finance developments, which also rely on soft financing sources as *gap filler* to reduce the hard debt and allow rents to be affordable to low-income households. FRF could be a critical source of financing that state Housing Credit agencies could pair with Housing Credit equity to get these deals done.

Unfortunately, while the final Treasury rule technically allows the use of FRF for affordable housing development, it presents several challenges to typical Housing Credit financial structuring. First, funds must be obligated by December 31, 2024, and expended by December 31, 2026.

This statutory deadline sets significant challenges to using FRF money effectively for long-term loans to serve as gap financing for Housing Credit developments. Any FRF funds used as a long-term loan can only cover "the cost of the loan," which means that other resources must be available to cover the remainder of the loan that isn't funded with FRF. This less efficient structure adds needless complexity to project financing, unnecessarily increases transactional costs, and is not a realistic solution for many developments.

While the statute and Treasury guidance allow FRF resources to be expended as grants, there are major impediments to the use of any federal grant in Housing Credit developments. First, federal grants reduce *eligible basis* in Housing Credit developments — essentially the amount of Housing Credit equity a project is eligible for is reduced proportionally when a grant is used as part of the financing. This negates the benefits of using these two resources together.

Second, for-profit developers receiving a grant typically need to treat that money as taxable income, which is often an insurmountable disincentive for a public-private partnership program like the Housing Credit. For this reason, gap filler sources are almost always provided as low- or no-interest long-term loans with flexible repayment terms.

Why is it so important that governmental entities have the ability to use SLFRF to build and preserve affordable rental housing?

The pandemic has created new challenges in affordable housing development, with supply chain disruptions, workforce shortages, and rising prices of construction-related commodities all driving up development costs. There simply are not enough soft funding resources available to fill the gaps, and Housing Credit properties in the pipeline are suddenly no longer economically feasible.

As of May 2022, approximately two-thirds of the states have dedicated or proposed FRF for affordable housing use, mostly through the state housing finance agencies. While not all state HFAs know yet exactly how much FRF funding their governors and legislatures will dedicate to affordable housing, those that do—just 18 state HFAs—already report approximately $8 billion committed for affordable housing investments. We expect that number to grow as more state policy makers make final decisions on how they will allocate FRF resources.

A sizeable majority of these states have specified some or all of those funds for use in Housing Credit development as a source of gap financing to cover the pandemic-related cost increases. In addition to these state commitments, there are many local governments with FRF dedicated or proposed for affordable housing development.

Demand for affordable rental housing significantly outstrips supply, and has for some time. But this supply challenge has never been more acute than it has since the beginning of the pandemic. With housing inflation driving overall inflation, and costs increasing far faster than incomes for so many families, we desperately need more supply, making Housing Credit production more important than ever. But without FRF, financing for these developments could easily fall apart.

How could Congress facilitate Housing Credit development with SLFRF?

Bipartisan leaders in both the House and Senate are trying to fix the problem so that states could leverage FRF with the Housing Credit. Representatives Alma Adams (D-NC) and David Rouzer (R-NC) and Senators Patrick Leahy (D-VT) and Susan Collins (R-ME) have introduced the LIHTC Financing Enabling Long-term Investment in Neighborhood Excellence (LIFELINE) Act H.R. 7078/S. 4181. This legislation would allow state and local governments to use FRF to make long-term loans to Housing Credit developments.

Under this legislation, loans would still need to be obligated by December 31, 2024 and expended for eligible costs by December 31, 2026, but a loan's maturity could be for 30 years or more and repayments on those loans could be made after 2026. Repayments on these loans could be recycled to use for other affordable housing activities, including for gap financing for future Housing Credit developments.

This approach conforms to typical Housing Credit development practices and eliminate the reduction in eligible basis and taxation implications of a grant. It also fulfills congressional intent that FRF resources be deployed promptly to support economic activity impacted by the pandemic.