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SUMMARY

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An Introduction to the Low-Income Housing Tax Credit

The low-income housing tax credit (LIHTC) program is the federal government's primary policy tool for encouraging the development and rehabilitation of affordable rental housing. The program awards developers federal tax credits to offset construction costs in exchange for agreeing to reserve a certain fraction of units that are rent-restricted for lower-income households. The credits are claimed over a 10-year period. Developers need upfront financing to complete construction so they will usually sell their tax credits to outside investors (mostly financial institutions) in exchange for equity financing. The equity reduces the financing developers would otherwise have to secure and allows tax credit properties to offer more affordable rents.

The most recent legislative changes that affected the LIHTC program were included in the law commonly referred to as the One Big Beautiful Bill Act (P.L. 119-21; OBBBA). Starting in 2026, the act permanently increases states' annual allocation authority by 12% and lowers the 50% tax-exempt bond financing requirement to 25%.

Prior to enactment of P.L. 119-21, the LIHTC program was estimated to cost the government an average of $14.4 billion annually. The changes made by P.L. 119-21 are estimated to reduce federal tax revenues by an additional $39 million in 2026, with the additional revenue loss increasing each year until reaching $4.0 billion in 2034 (the last year of the budget window).

Prior to P.L. 119-21, the most recent legislative changes that affected the LIHTC program were included in the Inflation Reduction Act of 2022 (P.L. 117-169; IRA). Those changes allowed developers that combine LIHTC with the Section 48 energy investment tax credit, the Section 48E clean electricity investment tax credit, or the Section 45L new energy-efficient homes credit to realize the full benefits of those credits without reducing LIHTC amounts. P.L. 119-21 terminated the Section 45L tax credit. The law also disallowed the Section 48E tax credit for solar water heating property and small wind energy property that is rented or leased to customers. Finally, with certain exceptions for geothermal energy, the Section 48 energy investment tax credit only applies to property commencing construction before 2025, so developers' ability to claim the Section 48 credit will be limited going forward.

The most recent legislative changes to the LIHTC program prior to P.L. 117-169 were contained in the Taxpayer Certainty and Disaster Tax Relief Act of 2020 (Division EE of P.L. 116-260), which set a permanent minimum credit (or "floor") of 4% for the housing tax credit that is typically combined with tax-exempt bond financing and used for the rehabilitation of affordable housing. The Taxpayer Certainty and Disaster Tax Relief Act of 2020 also increased, for calendar years 2021 and 2022, the credit allocation authority for buildings located in any qualified disaster zone. For 2021, the increase was equal to the lesser of $3.50 multiplied by the population residing in a qualified disaster zone, and 65% of the state's overall credit allocation authority for calendar year 2020. For 2022, the increase was equal to any unused increased credit allocation authority from 2021. Buildings impacted by this provision were also granted a one-year extension of the placed-in-service deadline and the so-called 10% test.

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Overview

The low-income housing tax credit (LIHTC) program, which was created by the Tax Reform Act of 1986 (P.L. 99-514), is the federal government's primary policy tool for the development of affordable rental housing. LIHTCs are awarded to developers to offset the cost of constructing rental housing in exchange for agreeing to reserve a fraction of rent-restricted units for lower-income households. Though a federal tax incentive, the program is primarily administered by state housing finance agencies (HFAs) that award tax credits to developers. Developers may claim the tax credits in equal amounts over 10 years once a property is "placed in service," which means it is completed and available to be rented. Due to the need for upfront financing to complete construction, developers typically sell the 10-year stream of tax credits to outside investors (mostly financial institutions) in exchange for equity financing. The equity that is raised reduces the amount of debt and other funding that would otherwise be required. With lower financing costs, it becomes financially feasible for tax credit properties to charge lower rents, and thus, potentially expand the supply of affordable rental housing.

Prior to enactment of the law commonly known as the One Big Beautiful Bill Act (P.L. 119-21; OBBBA), the LIHTC program was estimated to cost the government an average of $14.4 billion annually.[1] Changes made by P.L. 119-21 (discussed below) are estimated to reduce federal tax revenues by an additional $39 million in 2026 and by $4.0 billion in 2034.[2]

Types of Credits

There are two types of LIHTCs available to developers. The so-called "9% credit" is generally reserved for new construction and rehabilitation projects not utilizing certain additional federal subsidies,[3] and was originally intended to deliver up to a 70% subsidy. The so-called "4% credit" is typically used for projects utilizing federally tax-exempt bond financing and was originally designed to deliver up to a 30% subsidy.[4] The 30% and 70% subsidy levels are computed as the present value of the 10-year stream of tax credits divided by the development's qualified basis (roughly the cost of construction excluding land).[5] The subsidy levels (30% or 70%) are explicitly

[1] Computed as the average estimated tax expenditure associated with the program between FY2024 and FY2028. U.S. Congress, Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2024-2028*, JCX-48-24, December 11, 2024.

[2] U.S. Congress, Joint Committee on Taxation, *Estimated Revenue Effects Relative to the Present Law Baseline of the Tax Provisions in "Title VII – Finance" of the Substitute Legislation as Passed by the Senate for Reconciliation of the Fiscal Year 2025*, JCX-35-25, July 1, 2025.

[3] So-called "acquisition-rehab" projects allow for 9% credits to be used to subsidize rehabilitation costs, but not acquisition costs. However, 4% credits can be used to subsidize acquisition costs.

[4] The 9% credit is also commonly referred to as the "competitive credit" because awards of 9% credits are drawn from a state's annual LIHTC allocation authority and developers must compete for an award. The 4% credit is also commonly referred to as the "non-competitive credit" or "automatic credit" because developers do not have to compete for an award if at least 50% of the development is financed with tax-exempt bond financing; they are automatically awarded 4% tax credits. These 4% tax credits are not drawn from a state's annual LIHTC allocation authority.

[5] The present value concept allows for the comparison of dollar amounts that are received at different points in time since, for example, a dollar received today has a different value than a dollar received in five years because of the opportunity to earn a return on investments. Effectively, a dollar received today and a dollar received in five years are in different currencies. The present value calculation converts dollar amounts received at different points in time into a common currency—today's dollars.

specified in the Internal Revenue Code (IRC), though as discussed in the next section, they may be higher due to a number of legislative changes.[6]

The U.S. Department of the Treasury uses a formula to determine the credit rates that will produce the 30% and 70% subsidies each month. The formula depends on three factors: the credit period length, the desired subsidy level, and the current interest rate. The credit period length and the subsidy levels are fixed in the formula by law, while the interest rate changes over time according to market conditions. Given the current interest rate, Treasury's formula determines the two different LIHTC rates that deliver the two desired subsidy levels (30% and 70%).[7] In addition, for certain projects, the resulting credit rates may not be below a minimum (or "floor") of 4% or 9% (depending on the subsidy level), discussed in more detail below.

Once the credit rate has been determined, it is multiplied by the development's qualified basis to obtain the amount of LIHTCs a project will receive each year for 10 years. The credit rate stays constant throughout the 10-year period for a given development, but varies across LIHTC developments depending on when construction occurred and the prevailing interest rate at that time.

Minimum Credit Rates

The 4% and 9% credits have not always been exactly 4% and 9%. The Tax Reform Act of 1986 (P.L. 99-514) specified that buildings placed in service in 1987 were to receive exactly a 4% or 9% credit rate. Buildings placed in service after 1987 were to receive the credit rate that delivered the 30% and 70% subsidies as determined by Treasury's formula. The 4% credit rate determined under the formula has been below 4% every month since January 1988.[8] The Taxpayer Certainty and Disaster Tax Relief Act of 2020, enacted as Division EE of the Consolidated Appropriations Act, 2021 (P.L. 116-260), set a minimum credit (or "floor") of 4% on the 4% credit. In other words, the effective 4% credit rate cannot fall below 4%. This change applies to buildings placed in service starting in 2021 and is permanent.

The 9% credit rate had similarly been below its nominal 9% rate every month since January 1991 until the Housing and Economic Recovery Act of 2008 (HERA; P.L. 110-289) set a temporary floor of 9% under the credit. The minimum credit applied to developments completed in August 2008 through the end of 2013.[9] Following a number of temporary extensions, the floor became a permanent feature of the program in 2015 with enactment of the Protecting Americans from Tax Hikes (PATH) Act (Division Q of P.L. 114-113).[10]

[6] IRC §42(b).

[7] The choice of interest rate will affect the credit rate that is needed to deliver the specified subsidy levels. IRC §42(b) requires that the Department of the Treasury use an interest rate equal to 72% of the average of the mid-term applicable federal rate and the long-term applicable federal rate. The mid- and long-term applicable federal rates are, in turn, based on the yields on U.S. Treasury securities. It could be argued that this interest rate, also known as the discount rate, should be higher because LIHTC investments are riskier than Treasury securities. If this were true, then the LIHTC credit rate determined using the interest rate specified in IRC §42(b) would result in subsidies less than the 30% and 70%. Because Congress defined the subsidy levels to be 30% and 70% using the interest rate specified in IRC §42(b), this report does not consider how the use of alternative discount rates would affect the program.

[8] The 4% credit rate was 4% during the first year of the program. Since then the rate needed to produce the 30% subsidy has been below 4%. Novogradac & Company LLP, *Low-Income Housing Tax Credit Handbook*, 2006 ed. (Thomson West, 2006), pp. 845-850; Novogradac & Company LLP, "Tax Credit Percentages 2022," https://www.novoco.com/resource-centers/affordable-housing-tax-credits/tax-credit-percentages-2023.

[9] The floor technically applied to properties that were "placed in service" during that time period.

[10] The floor was originally enacted on a temporary basis by the Housing and Economic Recovery Act of 2008 (P.L. (continued...)

The effects of the minimum credits depend on how far the tax credit rates determined by Treasury are from 4% and 9%. The minimum credits have no effect if the credit rates produced by Treasury's formula are at least 4% and 9%; the credit rates will be determined by Treasury's formula and generate subsidies of up to 30% and 70%, respectively. If, however, the credit rates determined by Treasury are below the floors, then the credit rates are set equal to either 4% or 9%. When this happens, LIHTC projects can potentially receive subsidies above 30% or 70%, with the subsidies increasing the farther the credit rate determined by Treasury's formula is below 4% and 9%.[11] Treasury's formula produces low credit rates when interest rates are low and higher credit rates when interest rates are high.[12] In December 1990, when Treasury's formula last determined a credit rate above 9% (9.06%), the 10-year Treasury constant maturity rate was 8.08%.[13] In July 2025, the rate was around 4.42%.[14] Thus, interest rates would need to increase significantly from current levels for the floor to no longer have an effect.

An Example

A simplified example may help in understanding how the LIHTC program is intended to support affordable housing development. Consider a new apartment complex with a qualified basis of $1 million that is utilizing the 9% credit. Assuming for the purposes of this example that the credit rate is exactly 9%, the development will generate a stream of tax credits equal to $90,000 (9% × $1 million) per year for 10 years, or $900,000 in total. Under the appropriate interest rate, the present value of the $900,000 stream of tax credits should be equal to $700,000, resulting in a 70% subsidy. Because the subsidy reduces the debt needed to construct the property, the rent levels required to make the property financially viable are lower than they otherwise would be. Thus, the subsidy is intended to incentivize the development of housing at lower rent levels—and therefore affordable to lower-income families—that otherwise may not be financially feasible or attractive relative to alternative investments.

The situation would be similar if the project involved 4% credits except the developer would be entitled to a stream of tax credits equal to $40,000 (4% × $1 million) per year for 10 years, or $400,000 in total. The present value of the $400,000 stream of tax credits should be equal to $300,000, resulting in a 30% subsidy.

110-289) and applied only to new construction placed in service before December 31, 2013. The American Taxpayer Relief Act of 2012 (P.L. 112-240) extended the 9% floor for credit allocations made before January 1, 2014. The Tax Increase Prevention Act of 2014 (P.L. 113-295) retroactively extended the 9% floor through the end of 2014. Division Q of P.L. 114-113—the Protecting Americans from Tax Hikes Act (or "PATH" Act)—permanently extended the 9% floor.

[11] Treasury's formula is designed to produce credit rates necessary to deliver either a 30% or a 70% subsidy. These credit rates can be, and often are, less than 4% and 9%. For example, the July 2025 effective 4% credit rate, as determined by Treasury's formula, was 3.45% and the effective 9% credit rate was 8.06%. In this case, the 4% and 9% minimum credit rates take effect and the tax credit rates are set to exactly 4% and 9%, respectively. Because these credit rates are above what is needed to deliver a 30% subsidy (3.45%) and a 70% subsidy (8.06%), the subsidies could rise above 30% and 70% when the floors take effect. Projects are not required to receive the subsidy that results from either the Treasury formula or the minimum floors because IRC §42(m)(2) directs states' HFAs not to award a project more credits than is necessary to make it financially feasible.

[12] This relationship is an intrinsic feature of the present value formula, and not a result of a decision by Treasury in computing the credit rate.

[13] Board of Governors of the Federal Reserve System (US), 10-Year Treasury Constant Maturity Rate [DGS10], retrieved from FRED, Federal Reserve Bank of St. Louis, July 10, 2025, https://fred.stlouisfed.org/series/DGS10.

[14] Treasury does not directly use the interest rate on 10-year bonds, but as discussed in footnote 7, the interest rate used by Treasury is based on the yields on U.S. Treasury securities.

The Allocation Process

The process of allocating, awarding, and then claiming the LIHTC is complex and lengthy. The process begins at the federal level with each state receiving an annual LIHTC allocation in accordance with federal law. The administration of the tax credit program is typically carried out by each state's housing finance agency (HFA). State HFAs allocate credits to developers of rental housing according to federally required, but state-created, allocation plans. The process typically ends with developers selling awarded credits to outside investors in exchange for equity. A more detailed discussion of each level of the allocation process is presented below.

Federal Allocation to States

LIHTCs are first allocated to each state according to its population. In 2025, states have LIHTC allocation authority equal to $3.00 per person, with a minimum small population state allocation of $3,455,000.[15] Starting in 2026, state allocation authority will permanently increase by 12% due to changes made by P.L. 119-21, commonly known as the One Big Beautiful Bill Act. The state allocation limits do not apply to the 4% credits that are automatically packaged with qualified private activity bonds (PABs), a type of federally tax-exempt bond.[16] Through 2025, developers are eligible for an automatic award of 4% credits if they finance at least 50% of a project with PABs. Starting in 2026, this threshold is permanently reduced to 25% due to P.L. 119-21.

State Allocation to Developers

State HFAs allocate credits to developers of eligible rental housing according to federally required, but state-created, qualified allocation plans (QAPs). Federal law requires that a QAP give priority to projects that serve the lowest-income households and that remain affordable for the longest period of time. States have flexibility in developing their QAPs to set their own allocation priorities (e.g., assisting certain subpopulations or geographic areas), and to place additional requirements on awardees (e.g., longer affordability periods, deeper income targeting). QAPs are developed and revised via a public process, allowing for input from the general public and local communities, as well as LIHTC stakeholders. Many states have two allocation periods per year. Developers apply for the credits by submitting an application to state agencies.

Once a developer receives an allocation it generally has two years to complete its project.[17] Credits may not be claimed until a property is placed in service. Tax credits that are not allocated by states after two years are added to a national pool and then redistributed to states that apply for the excess credits. To be eligible for an excess credit allocation, a state must have allocated its entire previous allotment of tax credits. This use-or-lose feature gives states an incentive to allocate all of their tax credits to developers.

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[15] Internal Revenue Service, *Revenue Procedure 2024-40*, https://www.irs.gov/pub/irs-drop/rp-24-40.pdf. From 1986 through 2000, the initial credit allocation amount was $1.25 per capita. The allocation was increased to $1.50 in 2001, to $1.75 in 2002 and 2003, and indexed for inflation annually thereafter. The initial minimum tax credit ceiling for small states was $2 million, and was indexed for inflation annually after 2003.

[16] Tax-exempt bonds are issued subject to a private activity bond volume limit per state. For more information, see CRS Report RL31457, *Private Activity Bonds: An Introduction*, by Grant A. Driessen.

[17] Developers must have the property placed in service in the calendar year an allocation is made. However, a developer can receive an extension which gives them an additional calendar year to have the property placed in service. To be granted this extension, known as a *carryover allocation*, at least 10% of anticipated costs must be incurred within the first calendar year.

To be eligible for an LIHTC allocation, properties are required to meet certain tests that restrict both the amount of rent that may be charged and the income of eligible tenants. Historically, the "income test" for a qualified low-income housing project has required project owners to irrevocably elect one of two income-level tests, either a 20-50 test or a 40-60 test. To satisfy the first test, at least 20% of the units must be occupied by individuals with income of 50% or less of the area's median gross income (AMI), adjusted for family size. To satisfy the second test, at least 40% of the units must be occupied by individuals with income of 60% or less of AMI, adjusted for family size.[18]

The 2018 Consolidated Appropriations Act (P.L. 115-141) added a third income test option that allows owners to average the income of tenants. Specifically, under the income averaging option, the income test is satisfied if at least 40% of the units are occupied by tenants with an average income of no greater than 60% of AMI, and no individual tenant has an income exceeding 80% of AMI. Thus, for example, renting to someone with an income equal to 80% of AMI would also require renting to someone with an income no greater than 40% of AMI, so the tenants would have an average income equal to 60% of AMI.

In addition to the income test, a qualified low-income housing project must also meet the "gross rents test" by ensuring rents (adjusted for bedroom size) do not exceed 30% of the 50% or 60% of AMI, depending on which income test option the project elected.[19]

The types of projects eligible for the LIHTC include rental housing located in multifamily buildings, single-family dwellings, duplexes, and townhouses. Projects may include more than one building. Tax credit project types also vary by the type of tenants served; for example, LIHTC properties may be designated as housing persons who are elderly or have disabilities.

Properties located in difficult development areas (DDAs) or qualified census tracts (QCTs) are eligible to receive a "basis boost" as an incentive for developers to invest in more distressed areas. In these areas, the LIHTC can be claimed for 130% (instead of the normal 100%) of the project's eligible basis. This also means that available credits can be increased by up to 30%. HERA (P.L. 110-289) enacted changes that allow an HFA to classify any LIHTC project that is not financed with tax-exempt bonds as difficult to develop, and hence, eligible for a basis boost.

Developers and Investors

Upon receipt of an LIHTC award, developers typically exchange or "sell" the tax credits for equity investment in the real estate project. The "sale" of credits occurs within a partnership that legally binds the two parties to satisfy federal tax requirements that the tax credit claimant have an ownership interest in the underlying property. This makes the trading of tax credits different than the trading of corporate stock, which occurs between two unrelated parties on an exchange. The partnership form also allows income (or losses), deductions, and other tax items to be allocated directly to the individual partners.[20]

The sale is usually structured using a limited partnership between the developer and the investor, and sometimes administered by syndicators. As the general partner, the developer has a relatively

[18] Individual income levels are certified by each property manager, although states have some discretion over the specifics of the income verification method. LIHTC participants are prohibited from using HUD's Enterprise Income Verification (EIV) system to verify tenant income. The EIV system is required to be used in the Section 8 housing voucher program.

[19] Rent includes utility costs.

[20] For more details on the general tax equity mechanism, see CRS Report R45693, *Tax Equity Financing: An Introduction and Policy Considerations*, by Mark P. Keightley, Donald J. Marples, and Molly F. Sherlock.

small ownership percentage but maintains the authority to build and run the project on a day-to-day basis. The investor, as a limited partner, has a large ownership percentage with an otherwise passive role. Syndicators charge a fee for overseeing the investment transactions.

Typically, investors do not expect their equity investment in a project to produce income. Instead, investors look to the credits, which will be used to offset their income tax liabilities, as their return on investment. The return investors receive is determined in part by the market price of the tax credits. The market price of tax credits fluctuates, but in normal economic conditions the price typically ranges from the mid-$0.80s to low-$0.90s per $1.00 tax credit. The larger the difference between the market price of the credits and their face value ($1.00), the larger the return to investors. Investors also often receive tax benefits related to any tax losses generated through the project's operating costs, interest on its debt, and deductions such as depreciation. The right to claim tax benefits in addition to the tax credits will affect the price investors are willing to pay.

The vast majority of investors are corporations, either investing directly or through private partnerships. Financial institutions and banks are responsible for the majority of investment in LIHTC.[21] Partly this is due to the Community Reinvestment Act (CRA), which considers LIHTC investments favorably.[22] Other investors include real estate, insurance, utility, and manufacturing firms, which are seeking a return in the form of reduced taxes from investing in the tax credits.

The LIHTC finances part of the total cost of many projects rather than the full cost and, as a result, must be combined with other resources. The financial resources that may be used in conjunction with the LIHTC include conventional mortgage loans provided by private lenders and alternative financing and grants from public or private sources. Individual states provide financing as well, some of which may be in the form of state tax credits modeled after the federal provision. Additionally, some LIHTC projects may have tenants who receive other government subsidies such as housing vouchers.

Recent Legislative Developments

The most recent legislative changes that affected the LIHTC program were included in the law commonly known as the One Big Beautiful Bill Act (P.L. 119-21; OBBBA). Starting in 2026, the act permanently increased states' annual allocation authority by 12% and lowers the 50% tax-exempt bond financing requirement to 25%. Prior to enactment of P.L. 119-21, the LIHTC program was estimated to cost the government an average of $14.4 billion annually. The changes made by P.L. 119-21 are estimated to reduce federal tax revenues by an additional $39 million in 2026, with the additional revenue loss increasing each year until reaching $4.0 billion in 2034 (the last year of the budget window).

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[21] For more information on the LIHTC investor landscape, see CohnReznick, LLP, *Housing Tax Credits Investments: Investment and Operational Performance*, November 18, 2019.

[22] For more information on the LIHTC program and the CRA, see Office of the Comptroller of the Currency, *Low-Income Housing Tax Credits: Affordable Housing Investment Opportunities for Banks*, Washington, DC, April 2014, http://www.occ.gov/topics/community-affairs/publications/insights/insights-low-income-housing-tax-credits.pdf.

leased to customers. Finally, with certain exceptions for geothermal energy, the Section 48 energy investment tax credit only applies to property commencing construction before 2025, so developers' ability to claim the Section 48 credit will be limited going forward**.**

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