July 22, 2021

Neighborhood Homes Investment Act: Overview and Policy Considerations

The Neighborhood Homes Investment Act (NHIA; S. 98 and H.R. 2143) would create a tax credit intended to encourage the development of affordable homes for ownership in lower-income areas. The Biden Administration has called for passage of the proposal. The bill was previously introduced in the 116th Congress (S. 4073, H.R. 3316, and H.R. 2).

Overview of the Proposal

The NHIA would provide federal tax credits—known as the neighborhood homes investment credits (NHICs)—to offset the cost of constructing or rehabilitating owner-occupied homes. The credits would be awarded to project sponsors (e.g., developers), which would either use the credits directly to offset development and rehabilitation costs or sell the credits to investors to raise capital for home construction.

Under the bill, states would designate neighborhood homes credit agencies to screen sponsor applications and allocate credits according to a federally required, but state-created, qualified allocation plan (QAP). Each state would be allowed to annually award an amount of credits equal to the greater of (1) $6 multiplied by its population, or (2) $8 million. Annual allocation authority would be adjusted for inflation.

The mechanics of the NHIC would closely resemble the low-income housing tax credit (LIHTC), which is a federal tax credit for the construction and rehabilitation of affordable rental housing. The new markets tax credit (NMTC) and several energy-related tax credits also use the same general approach, which is often referred to as tax equity financing.

Selected Proposal Details

Eligible Development Types and Claimants

The credits could be used by developers to construct new homes or rehabilitate existing properties for sale. Homeowners who substantially rehabilitate—meaning incurring a cost of at least $20,000—their principal residence could also benefit from the credit, though they would have to partner with a business taxpayer (e.g., lender) because the credit could not be claimed by individuals. Credits could not be claimed until construction or rehabilitation were complete, and in the case of a sale, when the property was sold to a qualified homebuyer.

Eligible Property Types

Eligible property would be restricted to single-family homes containing four or fewer residential units; condominium units; and houses or apartments owned by a housing co-op. Second homes and rental properties would not be eligible for the credit.

Credit Amount

The credit amount would be equal to development costs minus the sales price, up to a limit. No credit would be allowed if the sales price covered development costs. The credit amount would be limited to no more than 35% of the lesser of (1) qualified development costs, or (2) 80% of the national median sales price for new homes as determined by the most recent census data. For an example of the credit calculation for new construction, see **Table 1**.

Table 1. New Construction Credit Example

Land Acquisition Cost	$40,000
Construction Cost	$200,000
Total Development Costs	**$240,000**
Less: Sales Price	($190,000)
Difference	$50,000
Tax Credit Limit (35% of $240,000)	$84,000
Tax Credit Allowed	**$50,000**

Source: Neighborhood Homes Coalition Presentation.

In this example, the tax credit amount allowed would be $50,000 (the difference between development costs and the sales price). Since this amount is less than the tax credit limit ($84,000), it is not subject to this cap.

Income Limits

Credits would be restricted to properties with occupants whose income did not exceed 140% of an area's or state's median income. A state's median income would be used for nonmetropolitan (i.e., rural) areas. The income limit would be the same regardless of whether the home was new construction or a rehabilitation project.

Sales Price Limits

The sales price of a property would be limited to four times the appropriate median income measure. This price limit would increase to five times, six times, and seven times the relevant area median income for properties with two, three, and four residential units, respectively.

Resale Timeframe Limit

Properties resold within five years of completion would require the seller to pay a portion of the gain from the sale to the state's neighborhood homes credit agency. The payment amount would be equal to 50% of the gain for sales occurring in the first year The payment amount would be reduced to 40% (year two), 30% (year three), 20% (year four), and 10% (year five), depending on when the sale occurred.

Location Restrictions

Credits would be restricted to properties located in a qualified census tract (QCT), as defined in the bill. QCTs are census tracts that generally have lower income levels, lower home values, and higher poverty rates.

Administration

The NHIC would be a provision of the Internal Revenue Code (IRC) and therefore would be administered at the federal level by the Internal Revenue Service (IRS). The primary administrators of the program, however, would be the state neighborhood homes credit agencies. Most states would likely designate their state housing finance agency (HFA) as the neighborhood homes credit agency, given HFAs' experience with administering the LIHTC program.

The federal government's principal housing agency, the Department of Housing and Urban Development (HUD), would have no direct oversight of the program unless other HUD subsidies were involved. HUD would be involved in some indirect aspects of the program's administration, such as identifying QCTs and providing the area median income data.

Selected Policy Considerations

Budgetary Cost

The Joint Committee on Taxation (JCT) would provide Congress with an official revenue estimate of any NHIC proposal. It is possible to get an idea of the budgetary impact since the proposals thus far specify that each state would receive credits authority equal to the greater of (1) $6 multiplied by its population, or (2) $8 million. Applying these dollar figures to the 2021 Calendar Year Resident Population Figures, used by the IRS for determining states' LIHTC and tax-exempt private activity bonds, suggests a NHIC would cost approximately $2.1 billion annually in terms of foregone federal tax revenue.

Sales Price and Development Cost Incentives

The NHIC would cover the difference between development costs and the sales price. If the sales price exceeded development costs, no credit would be allowed. If the sales price did not exceed development costs, then the credit amount would equal the difference, up to a limit. A potential concern could be that developers may lower their sales prices below what they could *otherwise* receive and not be as cautious containing development costs. This is because a lower sales price or higher development costs would be offset dollar-for-dollar up to the maximum credit limit. All else equal, this would result in fewer total properties receiving financing and would unnecessarily increase the per-property cost to the government. A lower sales price, however, would make homeownership more affordable even if the buyer would be willing and able to pay a higher price. Lower neighborhood home prices could also be of concern to existing owners.

The extent to which sales prices may be lower and development costs higher than they *otherwise* would be may depend on how well state HFAs determined if a project satisfied the financial feasibility requirement contained in the NHIA. This clause of the bill would require housing agencies to consider funding sources, proceeds, costs, and fees when determining if a credit award was appropriate. The ability to do this could vary across states and depend on staffing resources and valuation expertise. Some have raised concerns over how well HFAs are able to determine financial feasibility in the LIHTC program.

Existing Programs

At least two HUD programs currently exist that can be used to support the development of affordable owner-occupied housing: the HOME program and the Community Development Block Grant (CDBG) program. Both programs provide grants to states and localities, which have discretion over what types of housing initiatives to pursue. These programs do not specifically target the same homebuyers or locations as the NHIC, and certain program requirements may limit the extent to which funds can be used for some NHIC-eligible activities. Congress could potentially adjust these programs to accomplish the same objective as the NHIC. While direct grants may be more cost-effective than the tax equity approach used by the NHIC, the private sector serves a project oversight and evaluation role in tax equity deals that can be valuable to the government.

Data Collection and Oversight

The NHIA would require states to submit an annual report to the Treasury Secretary summarizing information about the program. It is not clear that these reports would be detailed enough to allow for evaluation of the credit's effectiveness or cost relative to alternatives, or for comprehensive oversight. Primary oversight would be provided by designated state agencies, likely the HFAs, which have experience administering the LIHTC program.

The IRS would have oversight of the NHIC at the federal level. HUD would have no direct oversight responsibilities. A 2015 GAO study found that the IRS provided little oversight of the LIHTC program and recommended that Congress designate HUD as a joint administrator of the program. A similar recommendation could be considered for the NHIC. However, without additional funding, this would likely just shift the burden to HUD without providing additional resources to carry out the directive.

Current law would prohibit the IRS from sharing detailed tax return information about NHIC with HUD (and most other researchers) to study the program. Congress could provide an exception to this prohibition, as it has to several other departments, under Section 6103(j) of the IRC. Congress could also direct states to report, and HUD to collect, detailed transactional data not reported to the IRS. This would not be a costless venture.

Mark P. Keightley, Specialist in Economics

IF11884

Disclaimer