



Six-Month Extension to Lease Units

by Thomas Stagg, CPA, HCCP, Partner Novogradac & Company

The Internal Revenue Service (IRS) issued Notice 2021-12 on Jan. 15 to provide temporary relief from certain low-income housing tax credit (LIHTC) requirements. For the first time, the relief included a provision that allowed units to be leased up after the close of the first year of the credit period and count toward a project's qualified basis for the previous year.

The language in Notice 2021-12 is very precise in what it does and does not affect. The section in question is as follows:

E. EXTENSION TO SATISFY OCCUPANCY OBLIGATIONS For purposes of § 42(f), if the close of the first year of the credit period with respect to a building is on or after April 1, 2020, and on or before June 30, 2021, then the qualified basis for the building for the first year of the credit period is calculated by taking into account any increase in the number of low-income units by the close of the 6-month period following the close of that first year.

Because the provision is new, there have been many questions about what it means and how it impacts the flow of credits and first-year credit calculations.

15-Year Credits

The most straight forward benefit of the provision is that it allows properties to include units leased through June 30, 2021, (for calendar year tax payers) in the calculation of its Dec. 31, 2020, qualified basis. Typically, units initially leased after the close of the first year of the credit period would result in an increase in qualified basis and therefore 15-year credits. For example, if a building that was supposed to generate \$1 million of credits was only 70% leased as of Dec. 31, 2020, typically it would either choose to defer the first year of the credit period or have 15-year credits equal to \$200,000 per year.



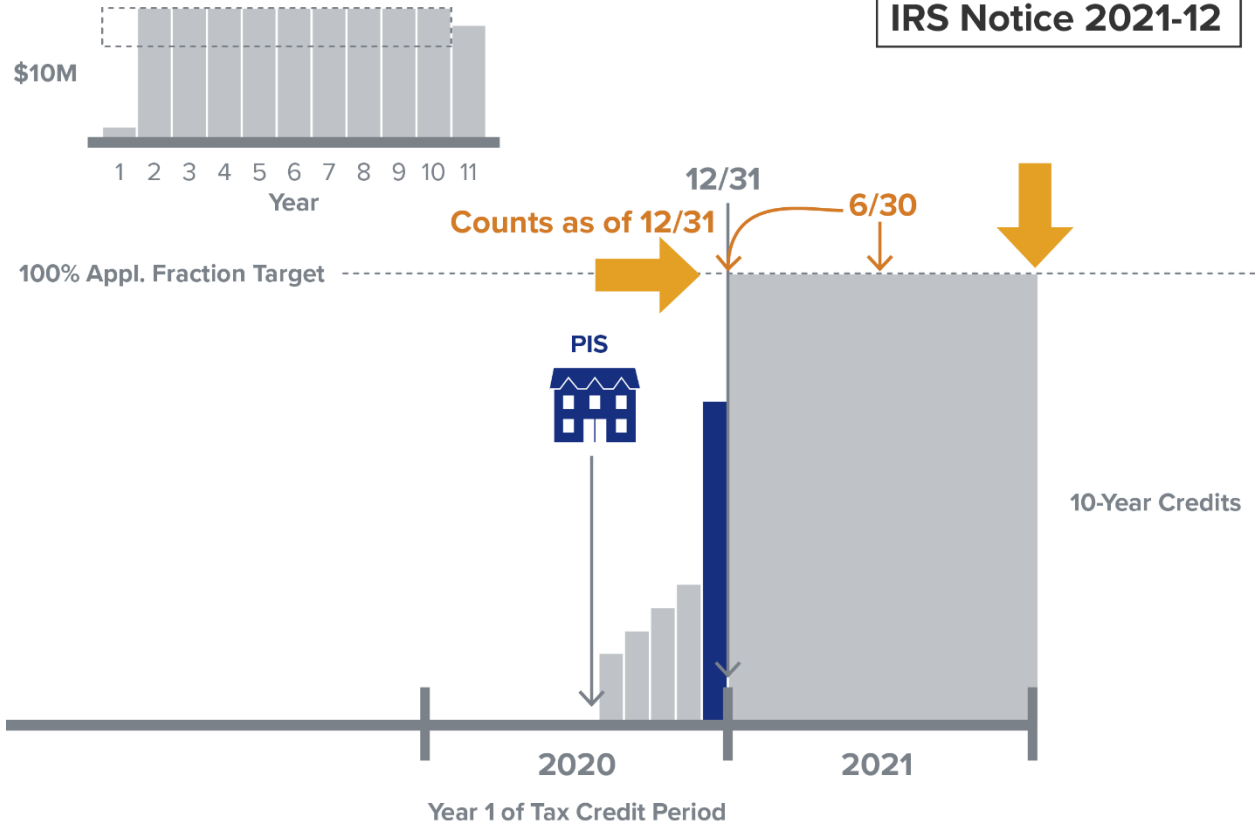
Source: Novogradac



However, under Notice 2021-12 if all units are leased by June 30, 2021, the Dec. 31, 2020, qualified basis would be 100%, and therefore, there would be no increase in qualified basis in future years. This would mean that the property would avoid 15-year credits.



IRS Notice 2021-12



Source: Novogradac



This is good news for developments that were worried about having to choose to defer the first year of the credit period and potentially face a timing adjuster that would lower the equity for the project or take 15-year credits and face a potential credit shortfall adjustment that would also lower the equity for the project. The property is now able to avoid 15-year credits and still deliver some credits in 2020.

Impact to First-year Credits

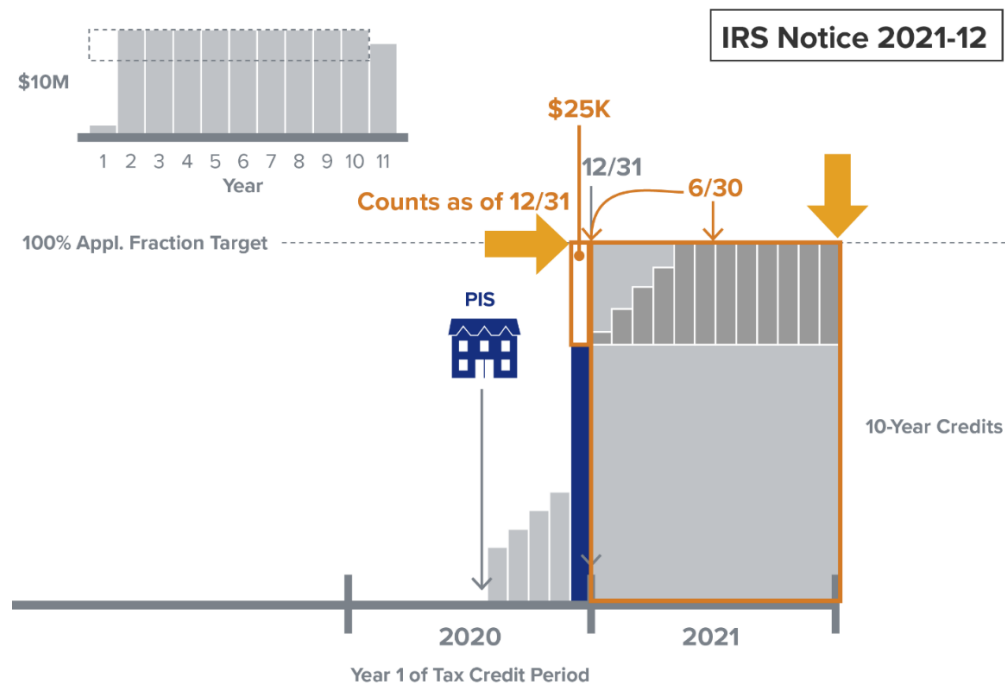
How Notice 2021-12 affects first-year credits is still unclear, and additional guidance from the IRS is needed to know for sure. In accordance with IRC Section 42(f)(2), first-year credits are determined based on the number of qualified units at the close of each month. Notice 2021-12 states that you can use these units in determining “the qualified basis for the building for the



first year” but does not tell us how or if that affects the first-year credit calculation. Absent further clarification from the IRS, we are left to only speculate. As of right now, there are two general schools of thought:

- No impact to first-year credits — Because Notice 2021-12 only impacts qualified basis as the close of the first year of the credit period, it does not impact the weighted average occupancy of the first year of the credit period, and therefore, there is no impact to the first-year credits.
- Small impact to first-year credits — Qualified basis is calculated by taking eligible basis times the percentage of the development that is affordable. Because property owners are allowed to lease up through June 30 to determine the building’s Dec. 31 qualified basis, it appears to indicate that the Dec. 31 applicable fraction would include units leased up through June 30, and therefore, when calculating first-year credits, owners would get to use 100% for December.

In this example, the difference between interpretation 1 and 2 is about \$25,000 of first-year credits.





Many developers and investors would love a more favorable answer that would allow them to increase the first-year applicable fraction even more for the units leased-up by June 30. This would require guidance from the IRS on how to calculate the first-year applicable fraction. The IRS could publish multiple interpretations such as using an 18-month average or picking the highest 12 months in the 18-month window, but without guidance from the IRS, it is unclear how first-year credits would be impacted by Notice 2021-12.

Overall Impact

The following table illustrates the difference between credit calculations with or without Notice 2021-12. Note this calculation assumes that the December applicable fraction would be 100%.

Year	100% Fix	Without Notice 2021-12		
	10-Year	10-Year	15-Year	Total
2020	\$160k	\$135k	\$-	\$135k
2021	\$1 mil	\$700k	\$150k	\$850k
2022	\$1 mil	\$700k	\$200k	\$900k
2023	\$1 mil	\$700k	\$200k	\$900k
2024	\$1 mil	\$700k	\$200k	\$900k
2025	\$1 mil	\$700k	\$200k	\$900k
2026	\$1 mil	\$700k	\$200k	\$900k
2027	\$1 mil	\$700k	\$200k	\$900k
2028	\$1 mil	\$700k	\$200k	\$900k
2029	\$1 mil	\$700k	\$200k	\$900k
2030	\$840k	\$565k	\$200k	\$765k
2031	\$-	\$-	\$200k	\$200k
2032	\$-	\$-	\$200k	\$200k
2033	\$-	\$-	\$200k	\$200k
2034	\$-	\$-	\$200k	\$200k
Total	\$10 mil	\$7 mil	\$2.75 mil	\$9.75 mil

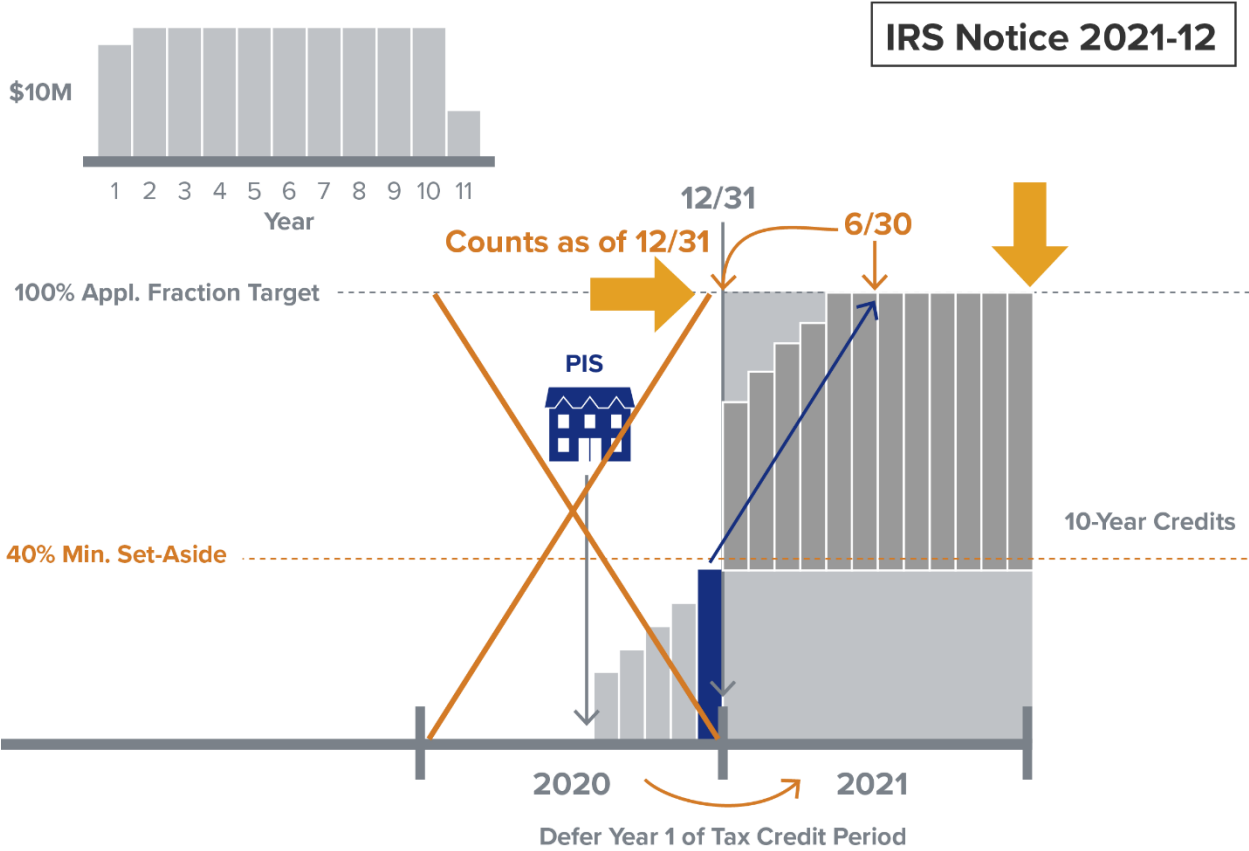
Source: Novogradac





Minimum Set-Aside Issues

If a property does not satisfy the minimum set-aside under IRC Section 42(g) at the close the first year of the credit period, it does not qualify for any credits. Unfortunately, this section of Notice 2021-12 does not provide any relief to properties that were not able to meet their minimum set-aside as of Dec. 31, 2020. Notice 2021-12 is limited to Section 42(f), and the minimum set-aside is under Section 42(g). So in order for a property to use this provision, it has to have met the minimum set-aside by the close of the year.



Source: Novogradac



Placed-In-Service in 2019 but Deferred to 2020

It is important to note that properties that were placed in service in 2019, but deferred the first year of the credit period to 2020, can still benefit from Notice 2021-12. The notice is applicable to properties "if the close of the first year of the credit period with respect to a building is on or



after April 1, 2020, and on or before June 30, 2021.” This means that if a building is placed in service, but the owner deferred the first year of the credit period to 2020, the building would qualify for the relief in Notice 2021-12.

Conclusion

Although this guidance doesn't appear to significantly increase first-year tax credits, it can still be a valuable tool for property owners who do not want to defer the first year of the credit period. Typically, deferring the first year of the credit period results in a significant reduction in LIHTC equity. To get the maximum benefit from Notice 2021-12, all units need to be leased up by June 30.

Thomas Stagg is a partner in the metro Seattle office of Novogradac & Company LLP. He has extensive experience with low-income housing tax credit (LIHTC) deal structuring, including assisting developers and investors in navigating acquisition/rehabilitation developments and Year 15 disposition issues. Mr. Stagg frequently speaks at industry events as well as Novogradac & Company LLP's affordable housing conferences and webinars. Mr. Stagg received his bachelor's degree in accounting from Brigham Young University. He is licensed in California and Washington as a certified public accountant.