ARTICLES

Tax Credit Housing, a Good Investment?

By Patty Monne

Nov 19, 2018

If you're a real estate investor looking for tax breaks investing in affordable housing, Tax Credit Housing may be the answer, but as a property owner, you need to be prepared to ask, and be asked, some important questions about risk management and liability.

Also known as Section 42, Tax Credit Housing refers to a section of the Internal Revenue Tax Code which provides tax credits to investors who build affordable housing. Investors receive a reduction in their tax liability in return for providing affordable housing to people with fixed or lower incomes.

Insurance companies that still underwrite this type of risk typically take a more cautious approach than other types of habitational properties and often have a maximum percentage of these type of units they will accept. They also may shy away from properties that are 100% subsidized, especially with elderly tenants, due to specific, unique risk exposures.

For instance, at a property for elderly tenants a woman wanting to take a bath drew the bathwater without realizing how hot the water was until she got into the tub. Unable to get out quickly, she was scalded. The woman filed suit against the property owners for not correctly regulating water temperatures. The claim was settled for $175,000.

Some carriers may also want to limit the amount of coverage for assault and battery they offer on these types of properties, especially if there have been past claims.

Protecting the property against the potential loss of tax credit status is also an important risk management issue. As a condition for receiving Housing Tax Credits, owners must keep the units' rents affordable -as defined by a calculation based on Median Household Income figures published annually by the U.S. Department of Housing and Urban Development (HUD), for a specified number of years. Fall short of the mark – number of affordable units, price of rent or length of rent rate – and you lose your tax credit status.

This can happen when a building suffers a loss and has to be restored to meet the requirements for section 42 (which may be delayed by either suspension or a delay in the restoration period of the property), or a reduction in the ability to rebuild the same number of low income housing due to zoning changes.

A real world example involved a fire at tax credit qualified property in Alabama that caused substantial

damage to enough units for the city fire department to declare the structure uninhabitable, and a total loss by the insurance carrier. City ordinances in place at the time of the incident forced a decrease in the number of original units that could be rebuilt by 20, dropping, dropping the building's percentage below the tax credit threshold.

Fortunately, policies for these type of properties can be endorsed with a special form titled Low- Income Housing Tax Credit Loss, which can provide a dollar amount to the owner in order to protect for the loss of their tax credits. In the above case, the property had a policy endorsement providing the owners with $2,500,000 of coverage for loss of tax credits, thereby avoiding an unexpected financial burden.

Tax credit housing can be challenging to master, following all of the guidelines takes focus and attention to detail. Like any real estate tax-saving venture, make sure you look at all the angles before you leap!

For a deeper dive on Tax Credit Property strategies and other risk management needs connect with a Risk Strategies Real Estate Practice expert today.

TAGS:
Real Estate