Community and Economic Development in North Carolina and Beyond Blog: Boosting LIHTC: Difficult Development Areas & Qualified Census Tracts

By CED Program Interns & Students

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The Low-Income Housing Tax Credit (LIHTC) program was designed to encourage the private development of affordable rental housing in the United States. (If you are new to LIHTC, check out the CED blog's primer on low-income housing tax credits before proceeding.)   But even with the dollar-for-dollar reduction in tax liability, affordable rental development is constrained in some areas by high costs or concentrations of low-income households.

To incentivize private developers into these "hard-to-serve" areas, the U.S. Congress mandates that the Department of Housing and Urban Development (HUD) designate special zones that can receive higher credit allocations. Projects situated in a Difficult Development Area or Qualified Census Tract qualify for a 30% boost in the LIHTC eligible basis, a significant increase in equity for a project. The eligible basis includes development costs that are subject to depreciation such as new construction, rehabilitation, and building acquisition and excludes costs such as land acquisition.

Difficult Development Areas

Difficult Development Areas (DDAs) were created to address the challenge of development in areas with high construction, land and utility costs relative to area median gross income. An example of an area with high costs-to-income might be a tourism destination with high property values but whose residents are primarily low-wage service workers.

Because data related to construction costs are generally unreliable or unavailable, HUD calculates the DDA ratio using fair market rents (FMR). This assumes high development costs translate into higher rents.   The ratio for determining a DDA is fair market rents (FMR) over the income of eligible tenants. FMR is generally based on the 40th percentile of gross rent paid by recent movers for a two-bedroom apartment. Since rents can vary considerably within a metropolitan area, as of 2016, HUD is relying on the small area fair market rent for larger MSAs.

The ratio's denominator is calculated as 30 percent of 120 percent of the very low-income limits (VLIL) divided by 12. This is the monthly LIHTC income-based rent limit and is meant to represent the maximum income of eligible tenants.

The DDAs are those with the highest ratios by metropolitan or non-metropolitan area that combined do not exceed 20 percent of the 2010 population of all metropolitan areas and all nonmetropolitan areas, respectively, in the country. North Carolina has 17 metropolitan and 16 non-metropolitan counties designated as DDAs.

Designations are updated annually with changes in the fair market rent and are usually effective on the first of the year. This mapping tool highlights changes in DDA designations between 2016 and 2017.

Qualified Census Tracts

Qualified Census Tracts (QCTs) "must have at least 50 percent of households with incomes below 60 percent of the Area Media Gross Income (AMGI) or have a poverty rate of 25 percent of more." The population of a census tract cannot exceed 20% of the total population of its metropolitan area.

HUD relies on income data produced by the American Community Survey (ACS) and designates QCTs as new tract-level census data becomes available. Although in the past QCTs rarely changed between decennial census releases, the shift to the ACS means that designations can change annually. A list of all QCTs by state is published here.

(A more detailed description of how the areas and ratios are determined are available on HUD's website.)

If a project is no longer in a DDA or QCT from one year to the next, the project may still qualify for the boost as long as the application is filed before the effective date of the new designation and the credit allocation is made within a year.

Regardless of whether the area qualifies under the DDA or QCT federal designations, states have the discretion to award the same 30-percent basis increase to projects that would not be financially feasible otherwise. "This state discretion applies only to buildings allocated credits under the state housing credit ceiling and is not permitted for buildings receiving credits in connection with tax-exempt bonds." The agency responsible for allocating LIHTC must establish rules for non-federal designations in its Qualified Allocation Plans (QAPs).

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