

DISTRICT OF COLUMBIA HOUSING FINANCE AGENCY

POLICY NOTIFICATION

Implementation of 25% Test for 4% LIHTC Bond-Financed Transactions

Effective Date: Transactions Induced on or After January 1, 2026

Background

Federal legislation enacted on July 4, 2025 (the "One Big Beautiful Bill") lowered the minimum Private Activity Bond (PAB) financing requirement from 50% to 25% of aggregate basis. This change reduces the amount of tax-exempt bonds required for 4% Low-Income Housing Tax Credit (LIHTC) eligibility, with significant implications for transaction structuring and volume cap utilization. **Aggregate basis is the total amount of building development and land costs associated with a qualified building. It will differ from eligible basis due to the inclusion of land and may include other additional items that are not capitalizable to the residential rental property component of the project.**¹ **Purpose of This Notification:** This bulletin provides advance notice to sponsors, developers, and development teams of DCHFA's planned approach to implementing the new 25% federal threshold for transactions closing on or after January 1, 2026. This notification is issued to allow sufficient time for transaction planning and structuring. Formal underwriting guidance will be incorporated into DCHFA's Multifamily Underwriting and Loan Policy through the Agency's standard policy update process.

DCHFA Policy (Applicable to Closings On or After January 1, 2026)

DCHFA will allocate tax-exempt Private Activity Bonds to 4% LIHTC transactions in an amount equal to the greater of:

- **30% of Aggregate Basis** , or
- **Maximum supportable permanent debt**

Policy Rationale

This framework balances two critical objectives:

1. Protecting Projects from LIHTC Disqualification

The 5% cushion (30% vs. the 25% federal minimum) protects developers from the severe consequences of failing the aggregate basis test due to cost overruns during construction. If a project's tax-exempt bond financing falls below 25% of the actual aggregate basis at placed-in-service, the IRS will issue LIHTC credits only in proportion to the actual bond financing percentage. For example, if bonds ultimately represent only 23% of aggregate basis, the project receives only 23% of anticipated credits, a material shortfall that typically renders the project infeasible. The 30% policy provides an adequate cushion for typical construction cost escalation while maintaining prudent underwriting standards.

2. Conserving Volume Cap Resources

By adapting to the new 25% federal threshold while maintaining practical underwriting standards, DCHFA can facilitate the production of more affordable housing units with the same amount of tax-exempt volume bond cap.

Key Guidance for Developers

For All New 4% LIHTC Applications:

Sponsors should structure transactions anticipating bond allocations consistent with this policy. This means:

- **Minimum bond sizing:** 30% of projected aggregate basis (or maximum supportable permanent debt if greater)

¹ Low-Income Housing Tax Credit Projects: All About the Bases. Clark Nuber PS

- **Construction contingency consideration:** The 5% cushion accounts for typical cost escalation, but sponsors must still minimize change orders and cost overruns
- **Pro forma requirements:** Financial models must demonstrate supportable permanent debt for the allocated bond amount

Cost Overrun Management:

While the 30% policy provides a cushion, sponsors remain responsible for:

- Accurate cost estimation at application submission.
- Proactive cost management during construction.
- Immediate notification to DCHFA of material cost increases.
- Contingency planning and communication with DCHFA if the project fails the 25% Test.

Underwriting Standards:

All standard DCHFA underwriting requirements remain in effect, including:

- Debt service coverage ratios
- Operating expense standards
- Rent and income restrictions
- Compliance monitoring requirements

DCHFA will continue to monitor market conditions and may adjust this policy based on industry experience, project performance data, and the supply and demand of tax-exempt bond volume cap.

Additional Considerations

Volume Cap Allocation

Volume cap requests should align with the 30% policy.

Implementation Timeline

This notification is effective immediately for planning purposes. The 30% policy will apply to all transactions induced on or after January 1, 2026.

DCHFA will incorporate this policy into its formal Multifamily Underwriting Guide. Updates to the formal underwriting guide will be communicated separately.

Questions and Additional Information

Development teams are encouraged to factor this framework into forward planning for all 4% LIHTC applications. DCHFA will continue to monitor implementation and provide updates as needed.

For questions regarding this policy notification, please contact:

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