



25 Percent Test Implementation Recommended Practices

Drafted by the Affordable Housing Tax Credit Coalition

For State and Local Housing Finance Agencies and
Housing Credit and Bond Allocating Agencies

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The Affordable Housing Tax Credit Coalition is a trade organization of housing professionals who advocate in support of the Low-Income Housing Tax Credit.

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SUMMARY OF RECOMMENDATIONS

- Setting a Private Activity Bond (PAB) Aggregate Basis Ceiling
- Establishing and/or Enhancing Bond Recycling Programs
- Maximizing PABs for Multifamily Development
- Providing Tools to Incentivize Developers to Return Excess Volume Cap
- Bifurcating 4% and 9% Policies to Maximization Bond Program Production

Preface

The One Big, Beautiful Bill Act, signed into law on July 4, 2025, lowered the bond financing threshold required to access 4 percent Housing Credits from 50 percent to 25 percent, unleashing tremendous potential to increase our nation's affordable housing supply.

The passage of the "25 percent test" presents a path to effectively double the current output of affordable housing financed by the 4 percent Low-Income Housing Tax Credit (Housing Credit) in states with over-subscribed PAB volume cap – estimated to finance over 1.14 million affordable homes over the next decade, according to Novogradac¹.

The best way to ensure that the necessary growth happens is a dual policy of carefully managing the state's PAB volume cap and adopting supporting policies that maximize debt and equity proceeds. This is a pivotal point in time, and one that requires proper guardrails to help facilitate the housing preservation and growth that country desperately needs.

Setting a PAB Aggregate Basis Ceiling: Part 1

To accomplish the balance needed to increase housing supply while also ensuring that bonds are used efficiently, we believe that a cap should be implemented on the percentage of volume cap that can be requested per project. The state can allow developers to meet the requirements of the 25 percent test and give a cushion to ensure that there are necessary funds available to ensure deals are financeable. We urge all state housing finance agencies (HFAs) and bond allocation agencies to adopt a cap on allocations of private activity bonds of no more than 27.5 percent to 30 percent² of aggregate basis per project.

¹ <https://www.novoco.com/notes-from-novogradac/senate-finance-committee-releases-fy-2025-budget-reconciliation-bill-that-includes-permanent-lihtc-expansion-novogradac-estimates-122-million-additional-affordable-rental-homes-over-2026-2035>

² It should be noted that a cap of 27.5% under the 25% test would be equivalent to a cap of 55% under the 50% test.



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Should HFAs wish, they can adopt additional language allowing them to waive this cap on a discretionary basis if a greater amount is necessary to secure permanent financing, or if in the future PABs are not oversubscribed.

Setting a PAB Aggregate Basis Ceiling: Part 2

We recognize that not all Housing Credit allocating agencies control the issuance of some or all multifamily private activity bonds in their respective jurisdictions. In these scenarios we recommend the allocating agency proactively engage with their respective sister agencies and local issuers to align PAB allocation priorities. In scenarios where Housing Credit allocating agencies do not control PAB allocations, we urge them to adopt qualified allocation plan (QAP) policies indicating that they will not issue or approve 4 percent Housing Credits for bond financed properties that are issued after December 31, 2025, if their original issued PABs (i.e. non-recycled bonds) exceed 30 percent of aggregate basis.

Establish and/or Enhance Bond Recycling Programs

We encourage state and local housing finance agencies to take immediate steps to set up multifamily private activity bond recycling programs. This will allow HFAs to stretch existing allocations of PAB volume cap further and offset the negative financial impact of having a higher proportion of taxable debt in the capital stack. In typical yield-curve environments taxable debt carries a higher interest rate, reducing the amount of debt proceeds available to finance affordable housing.

Establishing a multifamily residential rental housing bond recycling program benefits multiple stakeholders including:

1. The borrower, who benefits with lower interest rates and increased proceeds.
2. The state HFA, which benefits from larger issuances and increased fee potential that is associated with large transactions.
3. And most importantly, low-income individuals and families will benefit from increased affordable housing production.

Establishing a bond recycling program today positions agencies for future. The 2008 Housing and Economic Recovery Act (HERA) authorizes the reuse or “recycling” of multifamily private activity bond volume cap to finance new affordable multifamily rental housing projects under certain conditions. Such “recycled” bond volume does not entitle the new project to which it is allocated to qualify for 4 percent Housing Credits; however, as stated above it produces a much lower borrowing rate and in many transactions, enhanced feasibility.

There are several due diligence steps an HFA must evaluate before enacting a recycling program – the most important being whether the issuer has issued a sufficient volume of tax-exempt bonds in previous years that there are sufficient projected pay downs or pay offs that volume that can be recycled and justify the costs of



setting up a program. HFAs may consider the recycling programs in California, Colorado, New York, and Washington as potential templates. We note that there are several third-party firms that can assist HFAs in tracking and managing bond issuances should staffing bandwidth be a challenge in setting up a recycling program.

Maximize PABs for Multifamily Development

We urge HFAs and/or the state agencies and officials that manage and/or assign PABs to maximize allocations of PABs in 2026 to housing and to prioritize allocations specifically for multifamily housing over other uses. The legislative changes adopted in the One Big, Beautiful Bill Act will only achieve their intended outcomes if sufficient PABs are made available for 4 percent Housing Credit properties.

We recognize that PABs can be used to serve many important policy priorities and stakeholders, and that prioritizing PABs for multifamily housing implicitly may limit other potential uses. Given the housing supply crisis and the intent of Congress and the Administration to increased affordable housing production through the Housing Credit provisions in One Big, Beautiful Bill, we believe that this prioritization is warranted, at least in the short-term. Furthermore, every dollar of private-activity bonds leveraged in a multifamily Housing Credit transaction (up to the amount needed to meet the aggregate basis threshold test) can leverage more than one dollar of additional federal funds matching funds in the form of Housing Credit equity.³ No other use of PABs generates these additional as-of-right matching funds.

To appropriately scale PAB allocations for 2026, we encourage HFAs and bond allocating agencies to survey stakeholders to better understand current and anticipated PAB demand dynamics.

Tools to Incentivize Developers to Return Excess Volume Cap

We recognize that many potential transactions that will be eligible to leverage the 25 percent test have previously received awards of PABs at higher amounts. To be good stewards of the scarce resource while not negatively impacting the financial viability of previously funded projects, we encourage state agencies to consider adopting incentives to encourage developers to voluntarily return excess PABs. These incentives could take several potential forms including:

- Supplemental developer fees (which can be deferred) can compensate the developer for the increased financial risk and potentially generate additional tax credit eligible basis. This is an approach recently adopted by the California Debt Limit Allocation Committee.
- For states that have a hard-dollar cap on Housing Credits (per unit and/or total ceiling), HFAs should consider lifting this cap.

³ <https://www.bondbuyer.com/news/advocates-want-californias-pab-allocation-directed-to-housing> and <https://www.novoco.com/notes-from-novogradac/reasons-prioritize-private-activity-bonds-rental-housing>



- Create a competitive incentive for future competitive rounds to compensate developers for the lost permanent proceeds (e.g., a lottery priority or tiebreaker incentive).

Bifurcate 4 Percent and 9 Percent Policies to Maximization Bond Program Production

A growing trend among state housing finance agencies around the country is to develop bifurcated and differentiated 9 percent and 4 percent policies in key policy areas. This allows HFAs to carefully calibrate their policies and procedures for each program without triggering unintended consequences for the other program. This can be achieved through defined 4 percent and 9 percent sections within a single QAP and/or appendices, or by adopting separate QAPs for each program, as has been implemented in Ohio, Iowa, Tennessee⁴ and New Mexico⁵. There are several areas that could be differentiated to offset the negative financial impacts of a lower aggregate basis cap, including developer fees, limitations on acquisition basis, minimum design and construction requirements, income targeting requirements or incentives, minimum scores, geographic-based scoring, caps or limitations and/or outside leverage requirements.

Bifurcation strategies can produce more efficient and scaled 4 percent Housing Credit transactions that are less reliant on the need for soft-funds and/or “twinning” structures. The net result should be more unsubsidized bond deals which can empower HFAs to fund additional harder-to-finance but deeply impactful 9 percent projects serving rural areas, special needs populations and/or deeply income targeted populations. Bifurcated programs may also allow HFAs better meet the backlog of preservation projects, especially in communities where local soft-financing is not available for new construction.

⁴ Tennessee Housing Development Agency administers its 4% bond program in its Bond Program Description.

⁵ New Mexico Mortgage Finance Agency has indicated that it will adopt separate QAPs for the 4% & 9% programs in its 2026 program year.

