[Bonus] AFD Ep 381 Links and Notes - The Low-Income Housing Tax Credits of 1986

- **Intro**: This week's bonus episode is a bit of a complicated one to explain but seems like a good one to understand, especially if you are on the left as opposed to neoliberal and you are also interested in affordable housing and public provision of basic needs. We're talking about the Low-Income Housing Tax Credits of 1986, also known as LIHTC (often spoken aloud as "lie-tack" or "lie-tech"), which are still in effect today and serve as just about the only source of federal public funding, however indirectly, for the construction of new low-income housing stock. This program is something I didn't even learn about until becoming a City Councilor and then I discovered that people who are years or decades more experienced than me in office working on these issues also don't really understand how it works unless they have literally worked directly for an entity building or funding these housing projects, and so I've tried to explain it to as many people as I can. As usual, our sources will be up at Patreon.com/Arsenalfordemocracy with this episode, although in this case, we're mostly having to rely on more market-oriented, neoliberal sources for explanations and statistics, while we provide our own leftist critique of the views in the sources.

Our key source this week for the most purely informational material is a January 26, 2021 Congressional Research Service report prepared by Mark P. Keightly - https://fas.org/sgp/crs/misc/RS22389.pdf

- What is the Low-Income Housing Tax Credit system? Well it's going to remind many listeners a bit of how cap-and-trade systems are supposed to work, except it's somehow even more incompetent and nonsensical. Instead of giving grants to build low-income housing, the federal government gives out a tax credit to a developer (including for-profit developers) for having built some affordable housing. (For simplification today we won't get into all the technical requirements for how much and what levels of affordable housing are required to qualify, but you could imagine a project of say 50 units, all or nearly all with rents capped for various lower-income tiers, as a sort of typical mid-sized project. We're not talking about projects that are majority-market-rate and cross-subsidizing low-income units.) So once that federal tax credit is claimed by the developer after construction, the credit is then sold on for less than face value to a different corporation that wants to reduce its taxes. The developer assigned the tax credit sells it for as low as 80 cents on the dollar, converting the tax credit into cash to pay back the investors who funded the initial construction. The often unrelated company buying the credit on the market then reports to the IRS the full dollar value as a tax credit against what they would otherwise owe. Those credits add up to about $10 billion per year in federal tax expenditure through lost revenue collection. (And as a reminder, unlike a tax deduction which reduces your taxable income and thus slightly reduces your owed taxes, a tax credit reduces your actual owed taxes on a dollar-for-dollar basis at the end of the process, although of course the tax filer has paid some of that dollar to buy the credit.) Again, this tradable credits system – which only builds around 50,000 new housing units nationwide per year (and a similar amount of units are rehabbed annually, often by non-profits, for a smaller credit) – this entire system exists instead of the federal government just paying to develop affordable housing at a full dollar-for-dollar value.
    - Discussion -- Insane rube goldberg system! Neoliberalism! Everyone gets their beak wet on profits that solely exist due to government expenditure streams and the government pretends that it's saving money because it's not gathering together the upfront resources to fund an entire project or service and is letting the invisible hand of the market do that instead. Any problems that arise with the housing itself are kept at arm's length from the government. Gradually state capacity to provide basic needs directly fades away and the state only knows

how to give out money to private companies over time to do things it could do on its own, probably for less money total and certainly with more of the dollars actually going to the intended purpose instead of being partially diverted into investor profits.
    - Most importantly, the LIHTC system is totally insufficient even under its own limited logic. In many if not all markets in the US with a housing crisis for low-income people, **the converted market value of the LIHTC for a project does not actually cover the cost of the project** even when coupled with money that can be raised from bank loans and from for-profit investors who make their returns either from the actual rents or from the yearly sale of annual tax credits over a 10 year period, which means that the builders are forced to scrape together additional meager sources of funds from state and municipal governments until they have a package of funding that can actually make the project buildable. (On average 3.5 sources of funding per project and sometimes as many as 11 sources of funding, excluding LIHTC.) https://ternercenter.berkeley.edu/blog/lihtc-complexity/ In a sense, the tax credits once cashed in basically act to reduce the amount of necessary debt service to a bank on a project.
- [Rachel] Here is a hypothetical example from the Congressional Research Service report:
    - *A simplified example may help in understanding how the LIHTC program is intended to support affordable housing development. Consider a new apartment complex with a qualified basis of $1 million. Since the project involves new construction it will qualify for the 9% credit and, assuming for the purposes of this example that the credit rate is exactly 9%, will generate a stream of tax credits equal to $90,000 (9% × $1 million) per year for 10 years, or $900,000 in total. Under the appropriate interest rate the present value of the $900,000 stream of tax credits should be equal to $700,000, resulting in a 70% subsidy. Because the subsidy reduces the debt needed to construct the property, the rent levels required to make the property financially viable are lower than they otherwise would be. Thus, the subsidy is intended to incentivize the development of housing at lower rent levels—and thus affordable to lower-income families—that otherwise may not be financially feasible or attractive relative to alternative investments.*
- [Rachel] Here are some miscellaneous points that are worth understanding about this system:
    - 9% credits are for new construction. 4% credits are for rehabbing existing housing units.
    - LIHTC money is coming from the federal government but is administered to developers by the state governments, as assigned to them proportionally to the state's population. Credits are reserved by the state administrators ahead of a project and then paid out over a 10 year period once claimed following completion of construction. If a state doesn't use its proportional allocation of credit money within a period of two years, it returns to a federal pool to reallocate it to states with more projects in the pipeline.
    - Another weird wrinkle is that although the buyers of the traded tax credits are usually essentially unrelated to the development project, they do get legally partnered to it as a passive investor as part of the credit sale, after the project has been completed.
    - In 1989, the LIHTC system was slightly amended to require a minimum 30 year commitment to keep the rents restricted to low-income renters so that they can't

just be evicted in favor of market-rate tenants after a decade when the credits expire.
    - Sometimes the company cashing in the discounted tax credits is a major bank like Bank of America that might also actually be financing the construction. https://www.novoco.com/periodicals/articles/4-percent-lihtc-equity-market-persists-during-pandemic [Which makes them look better from a CRA standpoint; see Community Reinvestment Act https://www.federalreserve.gov/consumerscommunities/cra_about.htm *Congress found that banks have a continuing and affirmative obligation to help meet the credit needs of their local communities, including low- and moderate-income (LMI) neighborhoods where they are chartered, consistent with the safe and sound operations of the institutions. This finding was based on preexisting chartering laws that require banks to demonstrate that their deposit taking facilities serve the convenience and needs of their communities, which include credit and deposit services.*The Federal Reserve rates banks on a scale from noncompliance to outstanding]

https://en.wikipedia.org/wiki/Low-Income_Housing_Tax_Credit

[Rachel] 2009 paper from the Joint Center for Housing Studies of Harvard University about how the Recession affected the LIHTC tax credit market:
https://www.jchs.harvard.edu/sites/default/files/disruption_of_the_lihtc_program_2009_0.pdf

- During the last recession, major institutional investors temporarily stopped buying LIHTC because they were losing money overall and thus did not owe taxes on profits.
- The federal government did enact some emergency “gap financing” money, as opposed to credits, but only in the form of gap payments to recently approved and built affordable housing projects that now had no one interested in buying their tax credits for a couple years, which meant they wouldn’t be able to pay back their up-front investors.
- See the part about the difference between 9% and 4% credits (“The Four Percent Tax Credit Market Has Been Particularly Hard Hit”): 4% credits were ineligible for the Tax Credit Exchange program, which affects housing preservation projects, rather than new construction. The lack of investors willing to take on risk put already existing low-income housing stock in jeopardy, and hit nonprofits who are more likely to take on preservation projects, and acquire site control before tax credits are even sold, exposing them to more risk if they can’t find investors.
- One proposal in this paper is to shorten the period over which the credits are paid out to developers so that they can repay investors faster making it more attractive to provide the upfront cash to build a new project
- One incredible brain genius rube goldberg proposal from this 2009 paper during the recession’s immediate aftermath would have been (pp.41-42) to have the US Treasury Department itself step in to purchase Low-Income Housing Tax Credits from developers, similar to its purchases of distressed assets in the wider housing market.

- **The Tax Reform Act of 1986** https://en.wikipedia.org/wiki/Tax_Reform_Act_of_1986
    - This was a bipartisan round of major Reagan Tax Cuts in term 2. One of the big changes was a shift in tax policy toward favoring homeowners and away from favoring rental property landlords, which in turn discouraged rental housing stock from remaining as rental property as opposed to owner-occupied. One other feature of this tax reform changed certain rules about corporate real estate losses in a way that was probably good overall, because real estate is often used to disguise profits as losses, but which also ended up weirdly pushing

publicly-traded corporations with no particular interest in housing to be the bigger buyers of the low-income housing tax credits than actual real estate companies.

- **What did LIHTC replace in housing policy more broadly?** Well, there was a pretty long gap from 1973 until 1986 where the federal government wasn't really spending any money, either in direct subsidies or these tradable tax expenditures, due to Nixon's public housing construction moratorium. That ended the wave of New Dealer and Big Society public housing construction from the 1930s through the early 1970s. https://nlihc.org/resource/public-housing-history The 1973 moratorium on the 1937 and 1968 new housing programs was always intended to be temporary and new housing funding programs were supposed to be established by mid-1974, but that timed out to the absolute height of the Watergate scandal (https://www.nytimes.com/1973/04/16/archives/moratorium-onhousing-subsidy-spells-hardship-for-thousands-stricter.html) and the chaotic political situation essentially lost it in the shuffle. No one seemed overly motivated to revive federal housing spending after things had calmed down, and things just stagnated. In some classic famous last words, an assistant to the director of the H.U.D office in Washington said in 1973: "If the Administration comes through with an alternate housing proposal in a timely manner, then there should be no real setback."
- Low Income Housing Tax Credits have been applied to 3.23 million units of low-income housing built, rehabilitated, or acquired from out of the market-rate supply between 1987 and 2018. https://www.huduser.gov/portal/datasets/lihtc.html
- Discussion – LIHTC: Bipartisan then, today, and tomorrow?