



RESEARCH REPORT

The Low-Income Housing Tax Credit

How It Works and Who It Serves

Corianne Payton Scally Amanda Gold Nicole DuBois

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Executive Summary

The Low-Income Housing Tax Credit (LIHTC) is a complex but crucial tool for the production and preservation of affordable rental housing. Through this program, private investors receive a federal income tax credit as an incentive to make equity investments in affordable rental housing. Since 1986, nearly 3 million affordable housing units have been placed in service.

In this report, we outline the basics of the LIHTC program, including how it works, the various partners involved, how financing is structured, how investors benefit from the program, and who lives in the LIHTC properties. We also highlight successes of the program and examines the challenges it faces. This report is a companion to *The Low-Income Housing Tax Credit: Past Achievements, Future Challenges* (Sally, Gold, et al. 2018).

Program criteria require affordable rents to low-income households for a period of at least 30 years. A unit is considered affordable if the household is paying no more than 30 percent of its income for housing costs (including utilities). Some states require longer affordability periods.

The process for allocating tax credits competitively is guided by federal regulations and controlled by states. Federal regulations incentivize development in high-poverty census tracts and areas where development is most difficult because of high construction costs, among other criteria. State housing finance agencies also competitively distribute credits to projects based on priorities they set each year. Although tax credits can be used for mixed-income projects, most projects are 100 percent affordable to maximize the equity raised for the project.

Financing and structuring a LIHTC deal requires several partners. In addition to federal, state, and often local government agencies, deals involve equity investors, who invest in a property in exchange for tax credits; attorneys, who navigate the legal process; and project developers or owners, who build and manage the property. Sometimes other housing funds (such as the HOME Investment Partnerships Program and the Community Development Block Grant program, both run through the US Department of Housing and Urban Development) are leveraged to finance projects.

We need to know more about tenant characteristics. As of 2015, only 69 percent of LIHTC properties report data on tenant characteristics. Within those who report, response rates for certain questions vary. Only 80 percent of tenants from reporting properties respond to questions about income; only 68 percent report any data on race and ethnicity.

Although LIHTC is widely popular and is successful in producing and preserving critical affordable rental units, it continues to face challenges. Units are not required to be permanently affordable and need additional infusions of capital when equity investors take their money out of the property once tax benefits end. Further, the program does not serve the lowest-income households well on its own: many tenants need federal rental assistance to afford rents. Compared with other forms of housing assistance, LIHTC is economically inefficient because it drives up the transaction costs of affordable rental housing deals. The program structure, which encourages keeping costs low and constructing projects in low-income communities, can promote the concentration of units in poorer places. Finally, the LIHTC allocation process plus community opposition to developments can concentrate poverty and promote racial segregation.

We need more solutions for improving LIHTC. Although we know quite a bit about the program's structure, successes, and challenges, few evidence-based solutions for improving the program are available. More research should be done that focuses on long-term improvements to LIHTC and answers the following questions:

- What happens to properties after the 30-year affordability period? What are the best practices for maintaining affordability long term?
- How do we make LIHTC more efficient? What strategies could help streamline LIHTC financing, shorten project timelines, and reduce costs?
- How can we improve outcomes for communities and residents? How can LIHTC reduce residential segregation and increase access to opportunity?

LIHTC is the only major funding source for producing and preserving affordable rental housing. As such, it deserves a high level of scrutiny to ensure it is effective. Where it falls short, we should seek improvements and explore other options for expanding the supply of affordable rental housing.

The Low-Income Housing Tax Credit: How It Works and Who It Serves

The Low-Income Housing Tax Credit (LIHTC) has been a key policy tool for preserving and expanding the supply of affordable rental housing. Between 1987 and 2015, 45,905 projects and 2.97 million housing units have been placed in service (HUD 2017). By many accounts, it has been quite successful as a housing production tool, particularly when compared with other federal rental housing production programs.

LIHTC operates through the federal tax code. It was authorized through the Tax Reform Act of 1986 to give private investors a federal income tax credit as an incentive to make equity investments in affordable rental housing. The equity raised is used to construct new properties, acquire and renovate existing buildings, and refinance and renovate existing affordable rental housing properties that have previously been financed through other federal housing programs. These investments reduce the need for costlier methods of financing, such as bank loans, rendering lower affordable rents sufficient to sustain the property.

Because of its unique structure, LIHTC is one of the least understood tools for producing and preserving affordable housing compared with other federal housing assistance programs. It has different eligibility requirements determining who can live in financed units and what rents can be charged. There are two primary types of tax credits that a property developer can pursue, each with a different effect on the project's goals, finances, and outcomes. LIHTC deals are complex, involving private investors and partners spanning all levels of government as well as real estate finance specialists and legal and tax experts. Financing deals is equally complicated, particularly when the credit is layered with other funding sources that may have different requirements for household income, reporting, compliance, and other elements. Although affordability requirements are monitored, this is done primarily by state agencies, with the US Department of Housing and Urban Development (HUD) collecting basic data on a LIHTC project only for the year it is placed in service. The lack of standardized, granular data on financed properties over time makes it difficult to analyze exactly who benefits from living in LIHTC units.

In this report, we outline the basics of the LIHTC program, including how it works, the various partners involved, how financing works, how investors benefit from the program, and who lives in the LIHTC properties. We then highlight successes of the program and examine the challenges it faces, such as the lack of permanent affordability over time and of deep affordability for the poorest households, criticisms that the program concentrates poverty and promotes racial segregation, ongoing community opposition, and economic inefficiency.

Income Eligibility and Affordability Requirements

The basic requirements of the LIHTC program focus on how affordable the rents must be and how long those rents must remain affordable. A unit is considered affordable if the household is paying no more than 30 percent of its income for housing costs (including utilities). Eligibility criteria for housing programs is generally based on household income as a percentage of area median income, or AMI (box 1). The original LIHTC standard required that a minimum of 20 percent of the units in the property must be affordable to households earning 50 percent or below AMI or that a minimum of 40 percent of the units must be affordable to households earning 60 percent or below of AMI. The Consolidated Appropriations Act of 2018 (the federal omnibus appropriations bill passed in March 2018) amended this standard: now, households earning up to 80 percent of AMI are allowed in LIHTC-assisted units as long as the average income of all households in assisted units is 60 percent of AMI or below. In theory, this might help subsidize lower rents for lower-income households because including a household at 80 percent of AMI would require including a household at 20 percent of AMI; the previous requirements did not provide any incentive to serve families below 60 percent. It also provides more flexibility for households whose incomes might have risen somewhat during their tenure, allowing them to stay in the unit, and for property managers, who might face challenges finding enough residents who meet the income criteria.¹

In exchange for tax credits, properties are required to comply with investment regulations for 15 years and meet affordable rent requirements for at least 30 years, although some states have implemented longer affordability periods. Monitoring compliance involves regularly certifying that only targeted income-eligible households live in assisted units and are paying associated rents and conducting housing quality inspections. Investors in projects that fail to comply can lose their tax benefit.

BOX 1

Area Median Income

AMI is used as a measure of how a family's income compares with the median income of all families in a geographic area. It is commonly used by HUD to determine eligibility for housing programs to ensure that its programs are properly targeted to those who need them. It varies geographically depending on the community in which a household resides. Households earning between 0 percent and 30 percent of AMI are considered "extremely low-income," and households earning between 31 and 50 percent of AMI are considered "very low-income." Table 1 shows example calculations by county.

TABLE 1

Example Area Median Income Calculations for a Household of Four

County	50% AMI	60% AMI
District of Columbia	\$55,150	\$66,180
New York, Bronx, Kings, Queens, and Richmond Counties, NY	\$47,700	\$57,240
Orange County, FL	\$30,650	\$36,780
Corson County, SD	\$31,500	\$37,800
Choctaw County, AL	\$30,300	\$36,360

Source: Urban Institute analysis of "HUD 2017 Multifamily Tax Subsidy Projects Documentation System," US Department of Housing and Urban Development, accessed June 29, 2018.

Types of Credits and Allocation Process

The program offers two types of tax credits, a 9 percent tax credit and a 4 percent tax credit, that have different award processes, investor benefits, and financing structures. Both of them, however, produce newly constructed, rehabbed, or refinanced rental properties that follow the same income eligibility standards and affordability requirements.

The 9 percent credits are allocated to states annually by the IRS to distribute to eligible projects through a competitive process through state housing finance agencies. Award criteria are updated each year through a state's Qualified Allocation Plan, which outlines the state's priorities and scoring criteria (box 2). States with larger populations get the most tax credits to allocate. The Consolidated Appropriations Act of 2018 increased the amount of 9-percent credits available to states for the first time in a decade: for each year through 2021, all states and territories will receive at least \$3,105,000 of 9 percent credits each to allocate to projects or \$2.70 per capita, whichever is highest.²

BOX 2

Qualified Allocation Plans

A state's Qualified Allocation Plan helps determine which projects win LIHTC awards. Qualified Allocation Plans are typically updated yearly. Within these plans, states can

- require all applications to meet a minimum threshold, such as extending the affordability period to 50 years;
- set aside a portion of the tax credits to go only to projects with certain characteristics, such as preservation projects or those providing services to residents;
- determine where projects can be built, such as by establishing certain “opportunity standards” (e.g., low-poverty rates, access to public schools and transportation, good jobs and training) or, on the opposite end, prioritizing high-poverty neighborhoods; and
- provide scoring incentives, such as extra points for meeting sustainable green building standards.

The 9 percent credits are highly competitive, with many more projects requesting credits than can be funded. Because developers have strong incentives to score the most points possible, the preferences spelled out in a state's Qualified Allocation Plan have a powerful ability to shape the type and location of housing built.

Sources: CSH (2017); Global Green (2017); Ellen et al. (2015).

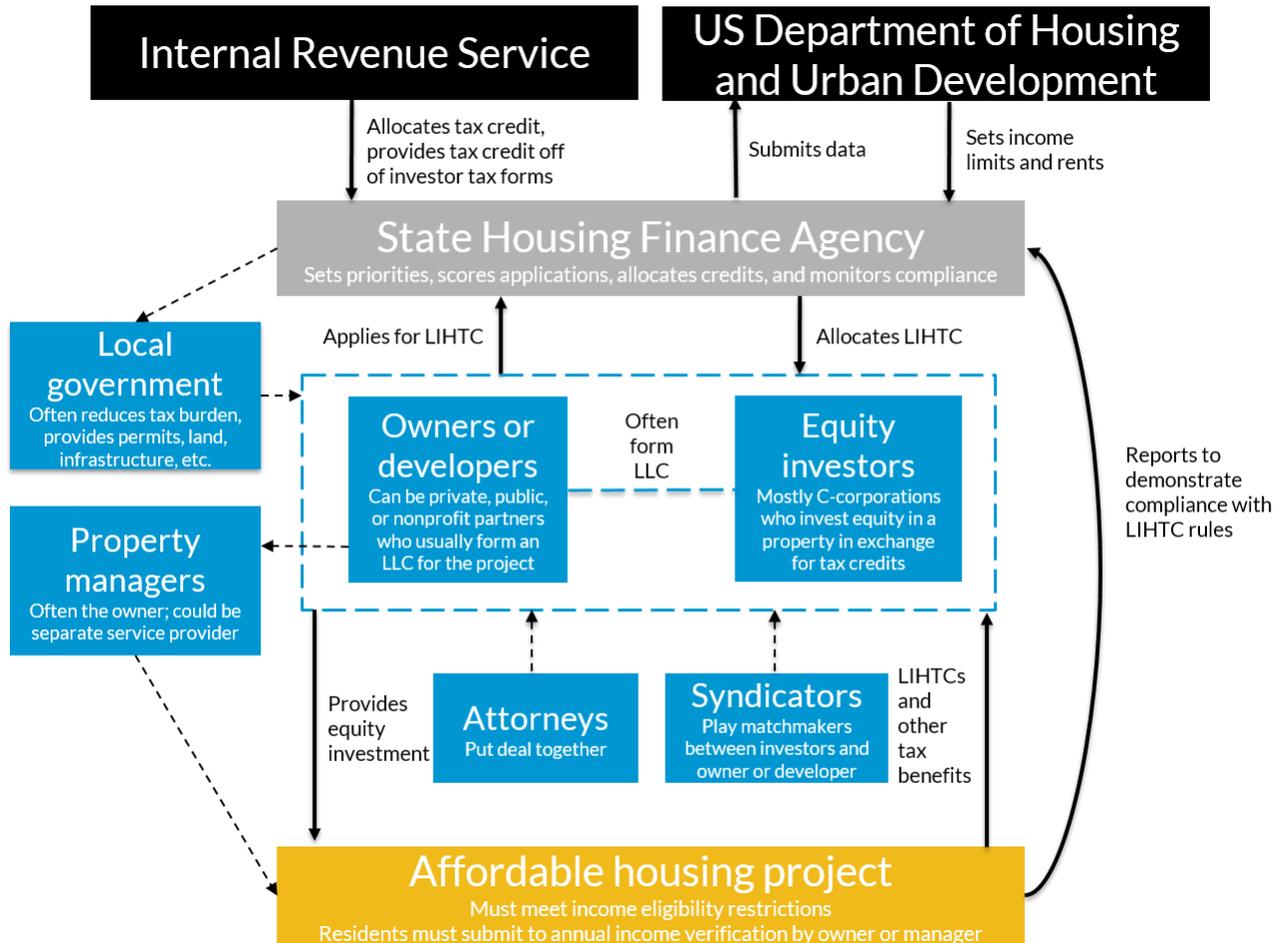
Projects that receive at least 50 percent of their funding through tax-exempt bond financing are eligible for 4 percent tax credits, and all projects that qualify may claim the tax credit without receiving an allocation from the state housing finance agency. Like the 9 percent credit, investors still claim tax credits over a 10-year period, and are subject to a 15-year compliance period. However, the bond transactions add to the project costs, and the after-tax yield for investors is lower (Office of the Comptroller of the Currency 2014). Since projects apply for the 4-percent credit individually instead of through the state, there is no ceiling on the total amount of 4-percent tax credits available in a given year.

Partners

Many partners are involved in structuring a LIHTC deal. At a minimum, projects involve actors from (1) the federal level, namely IRS and HUD, (2) state governments, in the form of the state housing finance agency, (3) the project level, comprising an owner or developer and investor who is assisted by other

real estate finance experts, and (4) the residents of the development. These actors, their roles and responsibilities, and their relationships to one another are presented in figure 1.

FIGURE 1
Partners in a LIHTC Deal



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Note: Each color denotes one of the four layers of a LIHTC deal: the federal government (black), the states (gray), the project developers (blue), and the project itself (yellow). Solid lines indicate a component common to all LIHTC projects; dotted lines indicate more complex partnerships that may or may not exist depending on how the deal is structured.

At the federal level, the IRS allocates tax credits, attaches the tax credit to the investor income tax forms, and enforces the initial 15-year period of compliance. HUD publishes income and rent limits, collects data, and maintains a database on properties and, more recently, tenant characteristics.

Each housing finance agency (state, territory, and in select cases, city) sets priorities for how they will allocate their credits by issuing Qualified Allocation Plans (box 2). Based on these priorities, they

score applications for the credits, award 9 percent tax credits or provide tax-exempt bond financing and 4 percent credits, and monitor the compliance and affordability periods.

The project level involves the most complex web of actors. Owners or developers propose a project. They can be private, public (including public housing authorities), or nonprofit partners. Each state housing finance agency must allocate 10 percent of its credits to nonprofit developers. Typically, developers form a limited liability company for the project with the investors. Equity investors, generally C-corporations, invest equity in a property in exchange for the tax credits (CohnReznick 2017). Attorneys are necessary to navigate the legal complexities of ownership, compliance, and tax law. Complex deals might involve multiple project developers and investment funds that are bundled together by a syndicator. Sometimes, local governments might reduce the tax burden to incentivize development; they are also critical in permitting construction activities and providing infrastructure. The properties themselves can be managed by the owner or by a separate service provider.

All residents must pass income eligibility requirements and submit to annual income verification by the property owner or manager to remain in the LIHTC-assisted unit. Although the program is structured to ultimately benefit residents through affordable rents, they are generally not involved in the LIHTC process before applying for and leasing a unit.

Financing

The LIHTC program provides direct equity from private investors in exchange for income tax benefits (box 3), reducing project need for debt and subsidies. As demand for tax credits has increased in recent years, it is not uncommon for 75 percent to 80 percent of the total project development cost to be financed through the equity raised from 9 percent tax credits. Other sources of funding typically include conventional mortgage financing (“hard debt”) and financing from government sources (“soft debt”). A recent survey found that, on average, tax credits finance about 55 percent of the qualified costs of a project, with 24 percent of financing coming from hard debt and 21 percent of financing coming from soft debt (CohnReznick 2017).

BOX 3

Investor Benefits

A typical affordable rental housing project that secures a LIHTC allocation generally benefits investors in two ways: (1) general tax savings earned by any rental property owner (not just LIHTC investors) by deducting the depreciation of the rental property plus operating losses, if any are incurred, and (2) the specific tax credits generated through LIHTC that can be used by the investor to offset federal income tax liability. Specific investors may benefit further, such as by receiving Community Reinvestment Act credit for investments from regulated lending institutions (Office of the Comptroller of the Currency 2014).

Investors claim tax credits for the first 10 years, compliance lasts 15 years, and the federal affordability period lasts 30 years. During the 15-year compliance period, the IRS can reclaim tax credits for properties that no longer serve required households. Most equity investors exit the partnership between years 11 and 16 (Office of the Comptroller of the Currency 2014).

Tax credits can only be used for affordable units, or those meeting the targeted income standards discussed. This is why many projects often contain 100 percent affordable units even though investors are allowed to develop mixed-income housing (which would mean offering some affordable units through LIHTC investments for lower-income households while offering the rest at market-rate rents). Additionally, projects built in areas designated as Qualified Census Tracts (where 25 percent or more of the population live in poverty or where at least half have income in the past year under 60 percent of AMI) or Difficult Development Areas (defined by HUD as “areas with high construction, land, and utility costs relative to area median gross income”) get bonus tax credits.³

LIHTC is often layered with other government funding because many LIHTC projects require other funding sources, particularly to reach the lowest-income households. These government sources include the federal HOME block grant, state housing trust funds, and the new National Housing Trust fund (box 4). LIHTC can also be layered on top of existing federal housing assistance programs, adding additional complexity (box 5).

BOX 4

Key Housing Funds Used in LIHTC Projects

The **HOME Investment Partnerships Program** (HOME) provides at least \$3 million annually through HUD to each eligible jurisdiction in the US, including all 50 states and the District of Columbia. These block grant funds can be used flexibly for a range of eligible activities according to the jurisdiction's Consolidated Plan. HOME is an ideal source of gap financing for LIHTC projects because of this flexibility (funds can be used for anything from security deposits to loan guarantees) and because certain criteria (including the low-income set-aside) align between the programs.

The **Community Development Block Grant** (CDBG) is another flexible source of HUD funding. Since its beginning in 1974, the CDBG has been an important funding stream that communities use to address a variety of eligible community development needs, including affordable housing. In fiscal year 2018, \$3.4 billion was allocated to 1,209 eligible jurisdictions through this program. Although program requirements stipulate a higher percentage of units must be set aside for low-income households (making it a less flexible program than HOME), the CDBG is still an important potential source of LIHTC funding.

State Housing Trust Funds exist in 47 states and the District of Columbia to promote affordable housing within their jurisdictions. Most are operated by a public or quasi-public agency, and their programs differ depending on state regulatory, tax, and policy environments. Eligible activities typically include rehabilitation and new construction, which pair well with LIHTC projects.

The **Affordable Housing Program of the Federal Home Loan Banks** began in 1990 following the passage of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989. Ten percent of Federal Home Loan Banks' net income funds this program, which granted \$324 million in subsidies in 2016, making it the single largest private source of affordable housing funds. Funds are disbursed based on local preferences to address specific community needs.

The **National Housing Trust Fund** was created by the Housing and Economic Recovery Act of 2008. In 2017, \$219 million were allocated to states, which are required to dedicate at least 80 percent of their grant to rental housing. Units assisted through these funds, through new construction or rehabilitation, are also subject to a 30-year affordability period.

Sources: Brooks and Anderson 2017; Coate 2014; "HOME Overview," HUD Exchange, accessed March 29, 2018, <https://www.hudexchange.info/programs/home/home-overview/>; "Affordable Housing," Council of FHL Banks, accessed March 29, 2018, <http://www.fhlbanks.com/affordable-housing.html>; "National Housing Trust Fund," National Low Income Housing Coalition, accessed June 29, 2018, <http://nlihc.org/issues/nhtf>.

Rental assistance is also often used to put LIHTC rents within reach of extremely low-income households earning less than what is required by the program. Some households receive rental assistance through the federal Housing Choice Vouchers program (which provides vouchers to eligible residents to find housing in the private market) or other programs serving homeless individuals or families. A 2009 study conducted by Abt Associates for HUD found that 47 percent of all LIHTC properties placed in service between 1995 and 2006 had one or more tenants with a voucher (Climaco et al. 2009). Other households may have access to rental assistance that is tied to the unit, such as the Rental Assistance Demonstration program, which converts public housing into rental units with long-term rental assistance contracts to help cover rents for lower-income households. Another study of LIHTC tenants in 18 different states found that about 70 percent of households living in LIHTC in this income category use some sort of rental assistance (O'Regan and Horn 2013).

BOX 5

Layered Financing Example with 4 Percent Tax Credits

The financing of some projects are quite complicated, requiring the layering of multiple sources of funding and involving multiple partners. The preservation of almost 800 units in 20 affordable housing communities across Tennessee that were originally financed through the US Department of Agriculture's (USDA's) Section 515 Rural Rental Housing program cost \$88.5 million and involved coordination across five separate partners: Greystone's affordable housing preservation group, Tennessee Housing Development Agency, the USDA's Rural Housing Service, and Hallmark Companies, Inc. Approximately 32 percent of the cost was financed through tax-exempt bonds and 18 percent through 4 percent tax credits. The remaining 51 percent of financing came from original USDA Section 515 debt, USDA guaranteed 538 loans and newly issued USDA Section 515 loans, and other sources.

Source: "Greystone Closes \$88.6 Million Affordable Housing Preservation Transaction in Tennessee," Greystone, news release, November 3, 2015.

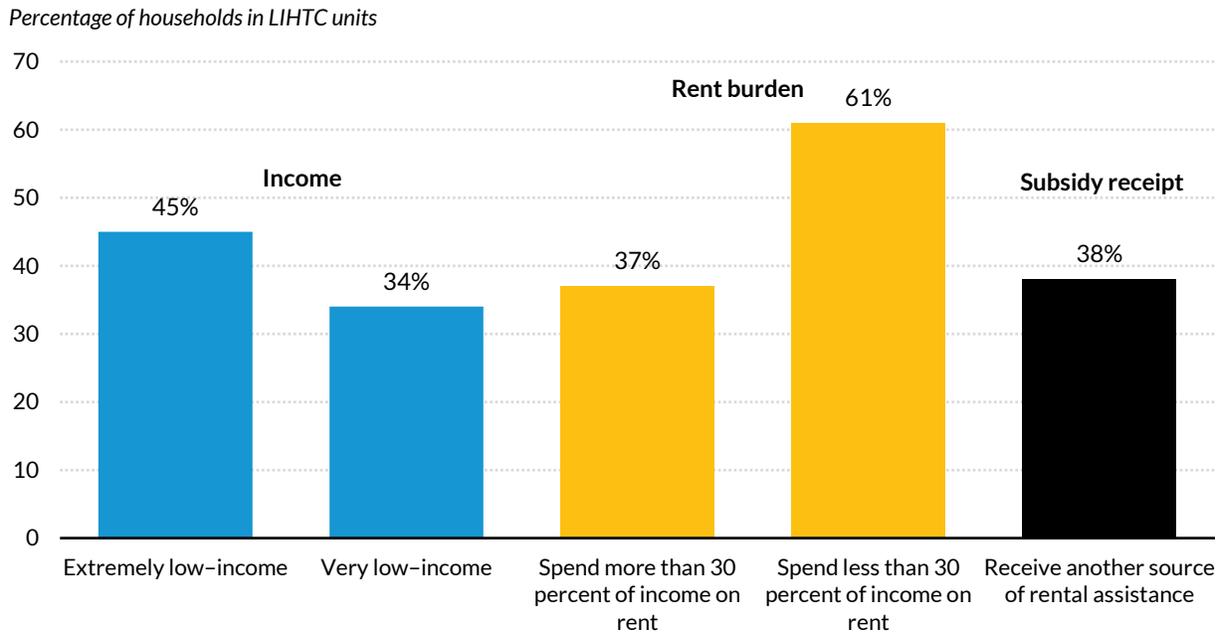
Tenant Characteristics

Data on tenant characteristics in LIHTC units are incomplete.⁴ As shown in figure 2, HUD (2018) data current through 2015 show that, based on 69 percent of properties that report data (and the 80 percent of those that report data on income), nearly half of LIHTC households are considered extremely low-income (earning less than 30 percent of AMI), and another one-third are considered very low-income (earning between 30 percent and 50 percent of AMI). The median income of a household in a

LIHTC-assisted unit is \$17,470; about 58 percent of households make less than \$20,000 per year (HUD 2018). Another study, examining tenant data from 18 states representing 40 percent of LIHTC units nationally, found that about 45 percent of LIHTC households are extremely low income (O'Regan and Horn 2013).⁵

FIGURE 2
Financial Characteristics of Tenants in LIHTC Units, 2015

Thanks to other rental assistance programs, LIHTC may serve more lower income households than expected



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Source: HUD (2018).

Notes: Sixty-nine percent of properties reported on income and rental assistance, and 79 percent of properties reported on household income and rent. These data reflect only the properties with data reported.

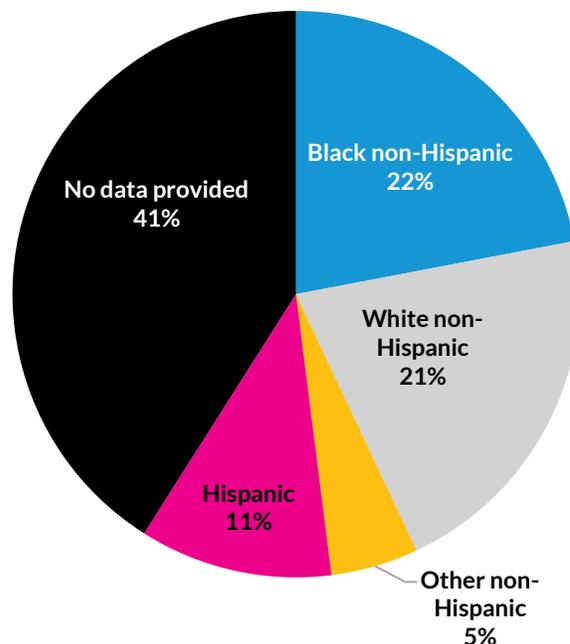
HUD data from 69 percent of properties show that nearly two out of every five households (38 percent) receive another source of rental assistance to help them afford their rent (HUD 2018). However, the partially complete HUD data might be a significant undercount: in their study of 18 states, O'Regan and Horn (2013) found that 70 percent of LIHTC tenants received another source of rental assistance. Finally, for those properties that O'Regan and Horn (2013) analyzed, 37 percent of tenants spend more than 30 percent of their income on rent and are considered rent-burdened.

Because of data constraints, it is unclear what types of households live in LIHTC-finance properties (HUD 2018). Only 77 percent of units reported data on household member characteristics. The data are further constrained to the 87 percent of reported households who also provide a valid date of birth for

at least one household member; other birthdates may be missing, making it difficult to determine whether children or adults over age 62 are members of a household. According to this limited data, 29 percent of households have at least one member under age 18, and 26 percent of heads of household are over age 62. Looking only at states with better response rates shows greater numbers of households with children or adults over age 62. For example, by limiting the sample to states with 90 percent or more of heads of households reporting, the percentage of those over age 62 rises to 32 percent. It is difficult to determine from this partial data how much LIHTC tenants differ from people receiving housing assistance through other federal programs.

Tenants do not have to provide their race or ethnicity because fair housing laws, so data are not complete in these categories. Only 68 percent of all LIHTC-assisted households report any data on race and ethnicity. Of these, 22 percent of heads of households are black non-Hispanic, 21 percent are white non-Hispanic, 11 percent are Hispanic, 5 percent are other non-Hispanic, and the remaining 40 percent do not report their race or ethnicity (figure 3). These figures should be interpreted cautiously (HUD 2018).

FIGURE 3
Racial and Ethnic Characteristics of Tenants in LIHTC Units
Percentage of heads of households



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Source: HUD (2018).

Note: 68 percent of Low-Income Housing Tax Credit properties report data on race and ethnicity.

Program Successes and Challenges

LIHTC is the longest running national affordable rental housing program producing new units. In contrast, public housing only funded new construction in earnest for 25 years (1949–73) and the Project Based Section 8 Rental Assistance program only generated new units for 10 years (1974–83). Most smaller project-based rental assistance programs have had no new funding for construction over the past few years.

LIHTC's longevity stems from bipartisan support, homebuilding industry support, and a history of strong program performance, all of which have been difficult to achieve for other federal housing programs. LIHTC appeals to a more progressive agenda of increasing the supply of affordable rental housing, but it also supports the more fiscally conservative goal of minimizing the cost to government while leveraging private investment. It also allows for a strong role for state governments in setting priorities and administering the program while requiring minimal HUD involvement. LIHTC functions smoothly from a federal perspective and has placed in service roughly 110,000 units a year, serving low-income households with little federal intervention.⁶ It also performs well financially for investors.

Although other sources of funding for affordable rental housing have declined, LIHTC has become the most critical method of preserving and expanding the stock of affordable rental housing. LIHTC has supported the redevelopment and transformation of public housing, beginning with HOPE VI in 1992 and continuing with its successor program, Choice Neighborhoods, in 2010 (Urban Institute and MDRC 2015). LIHTC is also used to preserve units originally financed through project-based rental assistance programs, including Section 8 Project-Based Rental Assistance, Section 202 Housing for the Elderly, and Section 811 Housing for People with Disabilities (Scally, Batko, et al. 2018). LIHTC has also been essential for preserving and expanding the supply of affordable rural rental housing: almost 100 percent of all US Department of Agriculture Section 538 guaranteed loans made for new construction and preservation have relied on LIHTC to provide equity (Scally and Lipsetz 2017). Some jurisdictions have even leveraged LIHTC with the allocations they receive from HUD following a disaster, through the Community Development Block Grant Disaster Recovery program.

Despite its successes, LIHTC continues to face challenges both old and new. Here, we summarize some of the main issues.

Units are not required to be permanently affordable. Initially, units were only required to meet affordability requirements for 15 years: the initial 10 years during which investors received the tax credits plus an additional 5 years during which tax credits could be reclaimed. In 1989, Congress extended this affordability period to a total of 30 years, although the IRS can only recapture the credits

for the initial 15-year compliance period. To extend affordability beyond this period, additional funds are necessary; these are often from other federal, state and local subsidies (discussed in more detail in box 3), and sometimes they come through new LIHTC investments in the same exact property and units. States must balance the need for the construction of new properties with the need to preserve older properties when allocating new credits. Some promising evidence suggests that most properties do maintain affordability over the 30-year period through new investments or some other means, and some states even impose longer affordability periods (Khadduri, Climaco, and Burnett 2012).⁷ Little is known on the effectiveness of this strategy, however, and little recourse is available when properties fail to comply (Schwartz 2015).

LIHTC does not serve the lowest-income households well on its own. Because of the program's requirements, LIHTC properties often serve households that make an average of 60 percent of AMI. Historically, the program has struggled to meet the needs of extremely low-income households, those earning 30 percent or less of AMI, without relying on additional federal rental assistance programs. The omnibus appropriations bill passed in March 2018 changed these targeting requirements, aiming to subsidize more extremely low-income households.

Although this challenge is not necessarily a program failing, it is troubling that in a time of rising rents and stagnant incomes, the primary program for constructing and preserving affordable units cannot provide rents low enough for many working families and older adults on fixed incomes without additional rental assistance, which is in such short supply that only one out of every five eligible households receives it (Kingsley 2017).

LIHTC is an economically inefficient method for producing affordable rental housing. The process of allocating and awarding tax credits is time consuming and complex. A study produced by the State of Washington found that it frequently takes twice as long to put together a LIHTC-financed project than one that is market rate, in turn contributing to higher legal and other transaction costs (Keightley 2017; Mitchell et al. 2009). Costs are also driven by the complexity of some LIHTC deals. A GAO (1997) study found that the process of syndication (pooling resources from multiple investors) can claim between 10 and 27 percent of project equity. LIHTC projects also have few incentives to keep costs low because reducing development costs would result in not using the full tax credit issued for the project (Mitchell et al. 2009).

Many studies have found that other programs, such as housing vouchers that pay a portion of a household's rent, are cheaper per unit or assisted household over time than LIHTC, although this is influenced by local conditions (Congressional Budget Office 1992; Deng 2005). Paying higher costs to

house populations with slightly higher (although still low) incomes is a possible trade-off required for raising private investment in affordable rental housing.

The program structure can promote the concentration of units in poorer places. Although the program only requires that 40 percent or more of the total units in the property be set aside as affordable, most properties are developed with affordability restrictions on all units to maximize the equity investment because only the affordable units qualify for tax credits. The allocation structure also provides an incentive to build in low-income communities designated as Qualified Census Tracts or Difficult Development Areas. Research has found that these areas tend to be adjoining, and they therefore contribute to clustering of LIHTC units (Dawkins 2011; Reid 2018). Combined with the search for the cheapest available land or buildings, these factors may also lead developers to place more units in lower-income communities. Recent research, however, finds that this effect may not exist; in fact, over time, LIHTC developments might contribute to a reduction in the poverty rates in existing high-poverty neighborhoods (Ellen, Horn, and O'Regan 2016).

Community opposition can stymie LIHTC development in places that may need it. Opposition, ranging from regulatory barriers preventing construction or driving up costs to active protests against affordable housing properties and tenants, influences the development and geographic distribution of LIHTC units (Scally and Tighe 2015). Many states formally or informally require local support of LIHTC project applications before they will be considered for funding. Communities can withhold their support and block development; lower-poverty neighborhoods are better equipped and perhaps more likely to block development of affordable housing (Scally 2012). A recent study found that states that increased preference to projects with community approval over the period 2002 to 2010 saw an increase LIHTC projects occurring in areas with exposure to poverty (Ellen et al. 2015). Maryland's practice particularly complicated development by requiring not only the approval of the community but also a local financial contribution. The effects of this policy led to the state being sued for violating Title VIII of the Civil Rights Act of 1968.⁸

LIHTC can exacerbate racial segregation, a repeated legal problem for affordable rental housing developments over the years. A legacy of discrimination in public housing and in state and local regulations preventing affordable housing development continues in some places (Turner, Popkin, and Rawlings 2009). In 2015, the US Supreme Court found the Texas state housing agency guilty of promoting racial segregation through its pattern of funding LIHTC units. A disproportionate number of units were awarded in black urban communities versus white suburban communities.⁹

We need more solutions for improving LIHTC. Although we know quite a bit about the program's structure, successes, and challenges, few evidence-based solutions are available for improving the program. More research should be done that focuses on long-term improvements to LIHTC and answers the following questions:

- What happens to properties after the 30-year period of affordability? What are the best practices for maintaining affordability long term?
- How do we make LIHTC more efficient? What strategies could help streamline LIHTC financing, shorten project timelines, and reduce costs?
- How can we improve outcomes for communities and residents? How can LIHTC reduce residential segregation and increase access to opportunity?

LIHTC is the only major funding source for producing and preserving affordable rental housing. As such, it deserves a high level of scrutiny to ensure it is effective. Where it falls short, we should seek improvements and explore other options for expanding the supply of affordable rental housing.

Conclusion

Between 1987 and 2015, LIHTC has placed in service 45,905 properties and 2.97 million housing units (HUD 2017). It is the longest running (and currently, the only) national program to consistently produce affordable rental housing units. Other federal programs rely on LIHTC to preserve existing rental units. For example, LIHTC has played a crucial role in the redevelopment of public housing into mixed-income communities, through older programs (HOPE VI) and newer ones (Choice Neighborhoods and the Rental Assistance Demonstration program). LIHTC has also been used in innovative ways to address community needs with the help of HOME, CDBG, and CDBG-DR funds. Because of its successes, LIHTC has enjoyed broad support from both political parties and the homebuilding industry.

Despite the popularity of the program, questions remain about how it works. LIHTC data quality and completeness has improved over the years, but gaps persist in several important areas. For example, HUD only started collecting data on tenants in 2010 and response rates are low and vary by indicator. Recent studies have attempted to gain insight into tenant characteristics and experiences, but a more rigorous federal data collection effort would be more informative. In general, detailed information about the LIHTC award process, its partnership structures, and project consequences is not available to the public. Little information is available publicly about tax credit pricing, especially pricing outside of large metropolitan areas, without a Freedom of Information Act request. Few examples of

LIHTC financing deals exist. These gaps in our knowledge make it difficult to address the challenges surrounding the program and to predict the consequences of not addressing them.

Because of its complex structure of partners and financing, LIHTC is vulnerable to market forces or modifications of the tax code. Changes in either could have profound impacts on the future availability of affordable rental housing. However, the lack of robust data and of public awareness of the program's contribution to the country's stock of affordable rental housing make LIHTC a challenging program to champion. For example, the recently passed Tax Cuts and Jobs Act likely affected investor demand for tax credits, but LIHTC was largely left out of debates around this legislation. We will not be able to understand the full impact of legislative changes for several years. Similarly, the 2018 omnibus appropriations act made permanent changes to household income eligibility requirements, and we can only wait to see how these will affect future investments in LIHTC as well as the lives of current and prospective LIHTC tenants.

In the companion to this report, *The Low-Income Housing Tax Credit: Past Achievements, Future Challenges* (Sally, Gold, et al. 2018), we explore some of these issues in greater depth, detailing why LIHTC matters to the federal safety net and diving into publicly available program data. By enhancing national understanding of LIHTC—how it works, who it serves, and the challenges and opportunities it generates—we can move the discussion forward on how to maximize the impacts of this vital program on the production and preservation of affordable rental housing across the country.

Notes

- ¹ Michael Novogradac and Peter Lawrence, “Omnibus Spending Bill Contains Affordable Housing Credit Improvement Act Provisions,” *Notes from Novogradac* (blog), March 21, 2018.
- ² H.R. 1625, Consolidated Appropriations Act, 2018.
- ³ Federal Register Notice FR—6043—N—01. “Statutorily Mandated Designation of Difficult Development Areas and Qualified Census Tracts for 2018.” 82 Fed. Reg. 174 (Sept. 11, 2017).
- ⁴ LIHTC, unlike many other housing assistance programs administered by HUD, is highly decentralized program. HUD relies on 64 different housing finance agencies to ensure compliance with the program, and rules surrounding affordability and monitoring vary between jurisdictions. Additionally, some jurisdictions are not mutually exclusive; for example, New York, Minnesota, and Illinois all allow a local city to control a portion of the state’s allocation. These factors complicate data collection on tenants in LIHTC units. Some housing finance agencies simply do not reliably report this data, although these data collection efforts have improved over the years. Even housing finance agencies that comply face challenges in data collection, especially from underreporting of all household members in a unit. For example, in 2015, nearly 70 percent of properties reported data, although the exact amount varies based on the indicator (HUD 2018).
- ⁵ For a more comprehensive look at tenant characteristics, and tenant perceptions of LIHTC housing, see Reid (2018), which takes a deep dive into 18 properties in California.
- ⁶ This is the number of units placed in service. The same unit can receive multiple subsidies, so this may double count units. Our analysis in the *Low-Income Housing Tax Credit: Past Achievements, Future Challenges* (Scally, Gold, et al. 2018) using unduplicated counts of LIHTC assisted units from the National Housing Preservation Database finds that the number of unduplicated units preserved or produced fell in recent years.
- ⁷ In some states, such as California, a longer period of affordability is mandatory. In other states, projects with a longer proposed period of affordability might be given preference in the applications process. Forty-one states included a requirement or a preference for longer affordability—ranging from 40 years to “in perpetuity,” like in Michigan, Vermont, and Massachusetts—as of 2001.
- ⁸ National Low Income Housing Coalition, “State of Maryland and HUD sign LIHTC Fair Housing Settlement,” news release, October 10, 2017.
- ⁹ Texas Department of Housing and Community Affairs et al. v. Inclusive Communities Project, Inc et al., 576 US ____ (2015).

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About the Authors

Corianne Payton Scally is a senior research associate in the Metropolitan Housing and Communities Policy Center at the Urban Institute. Her areas of expertise include federal, state, and local affordable housing programs and partners, covering topics from policy development and advocacy to program funding and implementation to on-the-ground development and operations. She is a former associate professor in urban planning at the State University of New York at Albany, as well as a former affordable housing developer. Scally received her BA in international affairs and MS in urban planning from Florida State University, and her PhD in urban planning and policy development from Rutgers University.

Amanda Gold is a research analyst in the Metropolitan Housing and Communities Policy Center at the Urban Institute. Her research interests include affordable housing and community and economic development. Before joining Urban, Gold interned with the Metropolitan Policy Program at the Brookings Institution, New York City's Department of City Planning, the Center for an Urban Future, and the National Housing Conference. Gold holds a BA from Kenyon College and an MPP from Georgetown University.

Nicole DuBois is a research assistant in the Metropolitan Housing and Communities Policy Center at the Urban Institute. Before joining Urban, she worked in community organizing in Iowa and Ohio and researched the privatization of the criminal justice system at In the Public Interest. DuBois earned her BA in government with minors in economics and justice and peace studies from Georgetown University.

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