How Trump Might Drain the Low Income Housing Tax Credit Swamp

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Whatever one thinks about the outcome of the recent election it does represent a change in direction for the country. Whether that change is for the better remains to be seen. When it comes to housing programs subsidized by the Low Income Housing Tax Credit (LIHTC) program established 30 years ago during the Reagan administration to promote the development of multifamily housing, there are some things that the new administration should carefully evaluate and perhaps change. Almost everyone agrees that subsidized housing costs more to produce than market rate housing; the question remains why and what could be done to change that.

The Office of the Controller of the Currency describes the LIHTC program as:

> "An indirect federal subsidy that finances low-income housing. This allows investors to claim tax credits on their federal income tax returns. The tax credit is calculated as a percentage of costs incurred in developing the affordable housing property, and is claimed annually over a 10-year period. Some investors may garner additional tax benefits by making LIHTC investments."

The credits are essentially a tax break for private investment in affordable projects, and these tax credits are then syndicated and turned into equity that offsets the costs of building multifamily projects with monthly rents at lower than 30 percent of the gross monthly income of people earning 60 percent or less of the local Area Median Income (AMI). The result is apartments with lower rents usually built by non-profit corporations (although some for profit developers use tax credits too). These units generally come with years long waiting lists. One local LIHTC project paid $45 million dollars for 112 units with a 5 year waiting list. This is considered a *success*.

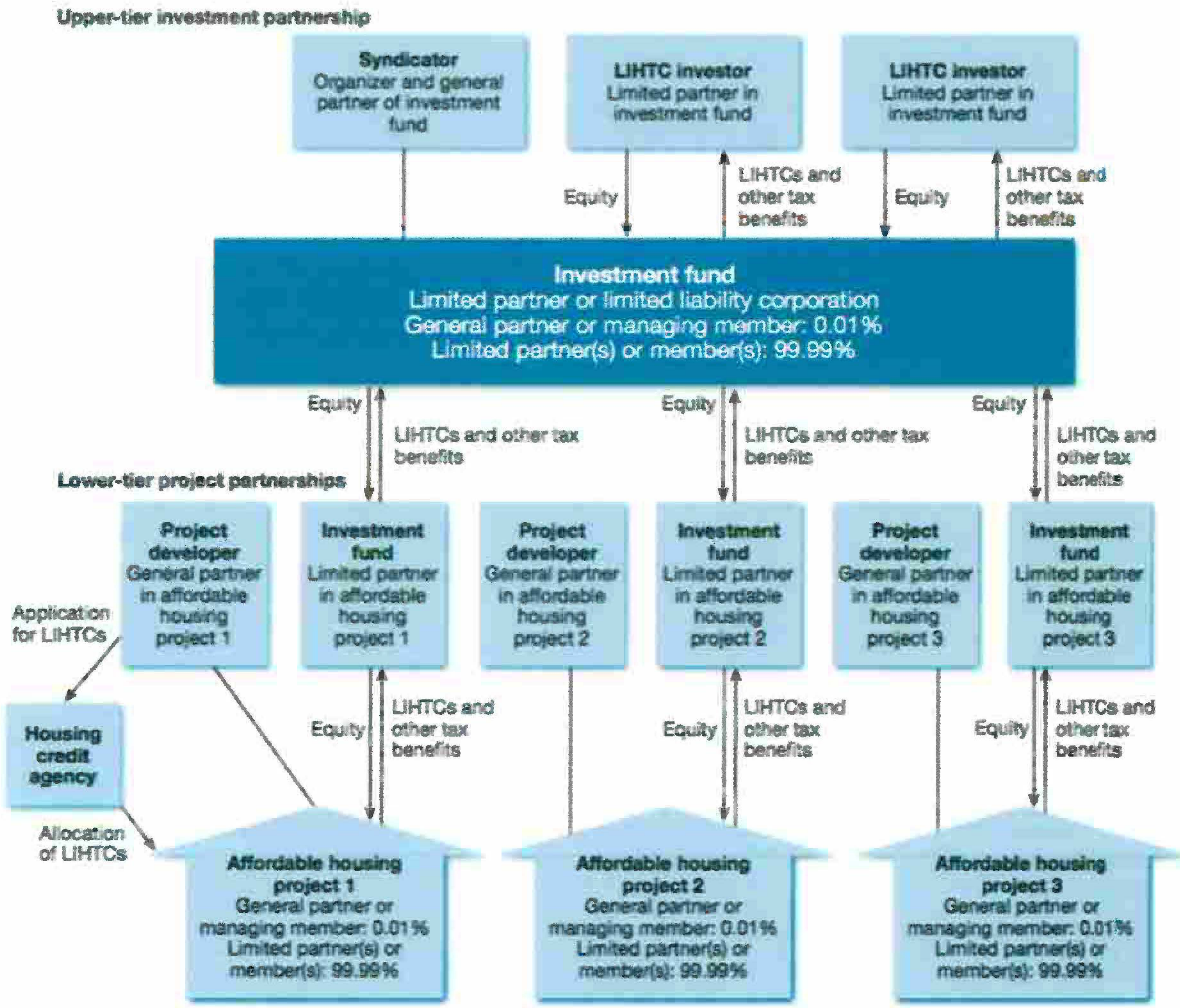
Studies by the states of Washington and California tried to get at a better analysis of the costs associated with LIHTC projects and how to improve the delivery of subsidized housing to the people who need it most. The California study found that local issues like neighborhood opposition, design review and parking requirements added to additional costs. But there are many other costs associated with transactions and financing affordable housing using LIHTC. The study didn't spend much time digging into transaction costs, and

Did not include a detailed breakdown of costs that are specifically associated with particular financing sources. For example, costs associated with the legal and administrative review and execution of financing contracts were not broken out from direct costs for securing financing sources. Construction delays and operational costs associated with securing multiple sources of funding were not analyzed.

The Washington study, however, concluded that after construction costs, "costs associated with financing, permitting, impact fees and reserve requirements" ate up about 9 percent of project budgets and that another 4 percent of project costs were "related to federal, state, or local government regulations such as prevailing wage, zoning, green building standards, and local government parking and design standards."

A review by my own organization, Smart Growth Seattle, found that "affordable housing projects have many unique costs, and often cost more because of financing, construction, and labor requirements. Affordable housing projects can be more expensive than market-rate due to some of these unique costs."

Figure 2: Typical Legal Structure for Investment in a Syndicated LIHTC-Equity Fund



The structure of LIHTC deals ends up being very complex (see the charts from the OCC explainer above), involving tax credit investors, local and state government agencies, and the federal government. All of these relationships and transactions to realize the benefits of tax credit equity in a project – lowered rents for the life of the project – end up adding time and costs. Along with having to comply with a myriad of regulations, like wage requirements and the local requirements it shouldn't be a surprise that per unit costs for "affordable" housing can be more than double that of market rate housing. In the case of the project I cited above, the cost is more than $400,000 per unit.

Here are three ideas for the new administration on how to make tax credits and other subsidies go farther and build more affordable units in fast growing cities:

- **Audit the LIHTC program and determine an objective measure of all costs associated with the subsidy**. When I was a developer of non-profit housing, we often talked about having to spend 50 cents to get a dollar of subsidy. The many costs associated with trying to produce affordable units is well known in the industry, but often advocates are reluctant to talk about those costs. It's easier to press the case for more money and more tax credits rather than making the system more efficient.

- **Remove the Davis-Bacon requirements for affordable housing. The Davis-Bacon act applies to projects that use LIHTC equity and this means having to pay prevailing wage**. The wages paid to workers on affordable housing projects can be much higher than regular wages or even fair wages depending on how those are defined. A Republican administration might more successfully challenge the lock that organized labor has on wages paid to workers on non-profit housing projects that end up driving up costs and reducing the number of units that can be built for needy families.

- **Change the definition of affordability.** The arbitrary way we determine what is affordable housing – 30 percent of gross monthly income for rent or housing costs – doesn't make any sense. The new administration could push for better-researched and useful measures that could expand housing options and change the subsidy structure for housing. Maybe direct cash subsidies for families would be more efficient than building a new and expensive unit. It would be easier to know that if we had a more sensitive measure. The government has undertaken a similar effort to revise poverty measures that have grown outdated too.

Roger Valdez is Director of Smart Growth Seattle, an advocacy organization for more housing supply, choice, and opportunity in Seattle.