Low-income housing tax credits increased—for better or worse

Practice Matters

By Charles Linn, AIA

Last December Congress enacted legislation that would increase the per capita value of federal income tax credits given to the Low-Income Housing Tax Credit Program (LIHTC) for the first time since 1986. This is good news for architects and developers—the majority of developer-constructed low-income housing built in the U.S. uses the credits. (Four out of the five projects in RECORD's last multifamily housing Building Types Study [JULY 1997, page 107] used them.)

The value of the tax credits given to each state will rise from $1.25 per state resident to $1.50 this year, and will increase again in 2002 to $1.75. Starting in 2003, the annual increase will be tied to inflation.

How the tax credits work

The program is administered by the Internal Revenue Service under Section 42 of the Internal Revenue Code. Credits are allocated to an agency in each of the 50 states, usually a state housing or finance agency. Each state agency, in turn, divides up the credits: A minimum of 10 percent of them must be reserved for nonprofit developers, and the remaining are granted to for-profit developers to help finance the construction or substantial rehabilitation of existing apartments. Each state has its own criteria for qualifying projects and developers.

To qualify for the 10-year tax credit, the developer must agree that for 15 years a portion of the apartments in the project will be rented to low-income tenants. Either 20 percent of the apartments must be rented to people whose income is 50 percent or less of the area gross median income (AGMI), or 40 percent must be rented to people whose income is 60 percent or less than the AGMI.

The tax credit is calculated by taking the building's depreciable development costs, excluding land (at least $3,000 per unit for renovations, or 10 percent of the building's eligible basis) times the percentage of units that will be designated as low-income units (qualified basis) times the 9 percent tax credit. This 9 percent figure can be subtracted from income tax owed each year over the next 10 years.

Many states offer their own tax credits. New York State, for instance, has an additional $2 million dollar-for-dollar tax credit program, plus four other programs that provide funding through tax-exempt bonds and low-interest loans.

Turning tax credits into gold

But tax credits don't build buildings—developers do, and what most developers need in order to build is cash. Once they receive tax credits, they can sell them to firms specializing in creating tax shelters. Developers can also retain ownership of their projects and keep the tax credits for themselves, but the idea is that developers who sell their credits have additional cash either for construction or for debt reduction on their project, so they can do a better job and still keep the rent low enough to accommodate the required number of low-income tenants.

Companies that buy these kinds of tax credits resell them to institutional investors, who use them to reduce their own federal income taxes. Demand for the tax credits has always outstripped supply, and the availability of additional credits will no doubt be used in the program. For example, New York State's allotment will increase from $22.7 million to $28.4 million this year, and will increase to $33.2 million in 2002. The market price of these credits varies with demand, but recently a dollar's worth of income-tax credit cost about 75 to 80 cents.

The down side

The number of housing units produced annually by the program has diminished over the years, as inflation has taken its toll on the $1.25 per capita tax credit. In addition, the boom in construction activity over the last few years has kept contractors busy, and bid prices on all kinds of construction have been higher, so that each dollar invested into housing construction has bought a bit less. Approximately 800,000 units of low-income rental housing have been created since the LIHTC was initiated in 1986, and over $10 billion in private funds has been invested in them.

Housing advocates point out that the number of low-income housing units available falls far below the number needed. A 1995 report called "In Search of Shelter: The Growing Shortage of Affordable Rental Housing," by the the National Center on Budget and Policy Priorities, a nonprofit that studies government spending, noted that there were 6.1 million low-cost rental units in the U.S., but 10.5 million renters. Last year's report from the National Low Income Housing Coalition, "Out of Reach 2000," noted that the median fair-market rent for a two-bedroom apartment in the U.S. demands a housing wage of $12.47 per hour, 242 percent of the minimum wage of $5.15 per hour.

Critics also point out that the LIHTC is an extremely awkward way to accomplish what is still in effect a housing subsidy, noting that while the rate of return for investors is good, in the end neither the government nor the tenants have any equity stake in what is built. After 15 years the owner can rent the low-income apartments at the market rate. The LIHTC financing also creates hidden costs: Fees must be paid to the syndicators who put together the tax credit deals; the creation of tax credit partnership agreements generates legal costs; and the syndicator charges annual fees for ongoing services. LIHTC financing also can add months to the development process.

The LIHTC comes off as a bad deal for a good ideal. It is now the only affordable rental housing program that developers can invest in, and it is unlikely that Congress would ever replace it. Both the developers who profit from it and the housing advocates who think more could be accomplished with the money seem to be united behind it. ■