Comment to the President’s National Commission on Fiscal Responsibility and Reform (NCFRR) in response to The Report on Tax Reform Options: Simplification, Compliance, and Corporate Taxation from the President’s Economic Recovery Advisory Board (PERAB)

Submitted by Enterprise Community Partners
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Introduction and Overview

Enterprise Community Partners (“Enterprise”) appreciates this opportunity to comment on the Report on Tax Reform Options from the President’s Economic Recovery Advisory Board (PERAB). While we understand that the report does not represent official Administration policy and is meant to explore possible tax reform options, we feel compelled to respond to suggestions that certain business tax expenditures should be repealed, including the Low Income Housing Tax Credit (LIHTC).

Our comment focuses in particular on two business tax expenditures: the LIHTC and the New Markets Tax Credit (NMTC). We encourage the NCFRR to support these tax provisions when drafting its tax-related recommendations. Our comment focuses primarily on the LIHTC because it has been in existence the longest; it has been subject to extensive evaluation that has shown its efficiency and effectiveness; it was specifically mentioned in the PERAB report; and because it is in many respects the basis for the NMTC.

Enterprise is a national nonprofit intermediary that provides capital and other assistance to support affordable housing and economic development in low-income urban and rural communities nationwide. Enterprise has deployed more than $10 billion in equity, loans, and grants to support the creation of nearly 300,000 affordable homes and help 6,000 low-income community businesses, among other activities. This investment has provided decent, affordable homes and economic opportunity for more than half-a-million people, and strengthened hundreds of low-income neighborhoods and local community-based organizations. Most of this activity has been generated by the LIHTC and NMTC.

The LIHTC is itself a result of tax reform. Congress enacted it as section 42 of the Internal Revenue Code in the Tax Reform Act of 1986. Prior to the Act, the Code contained various provisions to encourage investment in rental housing properties. These included accelerated depreciation schedules, five-year amortization of rehabilitation expenses and expensing of construction period interest and taxes. These tax provisions were widely regarded as inefficient and poorly targeted. Taxpayers could claim their full value even if only some apartments in tax-subsidized properties served low-income renters, while the rest rented at market rates.

The LIHTC effectively replaced and improved upon these tax incentives for rental housing by more closely tying tax subsidy to public benefit: credits can be claimed only after tax credit awardees actually build the apartments and lease them to low-income tenants with affordable rents. In enacting the LIHTC in the context of comprehensive tax reform Congress affirmed the importance of encouraging the private market to help provide affordable rental housing through the tax code, while demanding greater public benefit for the federal expenditure. Through the past 24 years the LIHTC has demonstrably met and arguably exceeded congressional objectives.

We have organized our comment to address the public purpose, effectiveness, and efficiency of the LIHTC, as well as its role in comparison and contrast to the Housing Choice Vouchers program, which the PERAB report suggests may be able to address affordable housing needs at a lower cost.
Public Purpose

The purpose of the LIHTC is to enable the private market to provide newly constructed and rehabilitated rental homes that low-income families and individuals can afford. According to a Government Accountability Office (GAO) report reviewing the program: “In establishing the tax credit incentive, Congress recognized that a private sector developer may not receive enough rental income from a low-income housing project to (1) cover the cost of developing and operating the project, and (2) provide a return to investors sufficient to attract the equity investment needed for development.”

The LIHTC provides taxpayers a dollar-for-dollar reduction in federal income taxes for investments in rental housing developments serving low-income people for no less than 30 years. The amount of tax credit is based on a percentage of eligible development costs and claimed over a ten-year period. Tax credits can only be claimed with respect to costs incurred to provide housing for low-income families at affordable rents and in good condition for at least 30 years. Specifically, LIHTC-assisted homes must be rented affordably to tenants whose income does not exceed 60 percent of area median income (AMI). By way of illustration, 60 percent of the national median household income for a family of four is roughly $30,000 according to the Census Bureau’s American Community Survey data released in September. This income level varies significantly by area.

In practice the LIHTC serves much lower income tenants on average than the law requires. The GAO found that LIHTC renters earn on average 37 percent of their AMI.\(^2\) GAO found, and other evaluations have confirmed, that nearly 40 percent of LIHTC renters have incomes of 30 percent or less of AMI and three quarters earn 50 percent or less of AMI. Thirty percent of AMI and below is considered extremely low-income with respect to federal housing programs. On a national basis, this income level is about $15,000 annually. Fifty percent of AMI and below is considered very low-income and is approximately $25,000 annually.

Recent data from the Census Bureau found a huge shortfall in the supply of homes for extremely low-income people. Analysis of these data found that there were only 37 units of housing affordable and available for every 100 extremely low-income people in the country, representing a national shortage of over 2 million units.\(^3\) While the LIHTC cannot address this shortfall entirely on its own, it, along with the recently authorized National Housing Trust Fund and rental subsidy, will play a key role in addressing this very important national affordable housing need.

Not only has the LIHTC produced quality, affordable apartments for the lowest income Americans, the LIHTC brings well-designed, affordable rental housing to a wide variety of communities—from inner cities to rapidly growing suburbs to rural towns. It builds new affordable apartments and saves valuable at-risk existing affordable housing. It provides affordable homes to working families and vulnerable populations with special needs—the elderly, people with disabilities, and people who are homeless. It addresses the housing needs of acutely underserved communities, such as farmworkers and Native Americans, and it is the key housing resource for transformative community redevelopment and revitalization efforts nationwide.

This flexibility in addressing different housing needs is reflected in the program’s importance to multifamily housing in general as the nation is beginning to recover from the recession. According to a recent analysis from the National Association of Home Builders (NAHB), the LIHTC represented half of all multifamily starts in 2010.\(^4\) This demonstrates that the program is keeping capital flowing for multifamily housing, as well as keeping the many types of small businesses in the construction industry—architects, engineers, plumbers, electricians, carpenters, concrete fabricators, bricklayers, roofers, and other specialties—in business and their employees employed.
Effectiveness

The LIHTC has proven to be remarkably effective by a number of metrics. First and foremost, it does what Congress intended it to do: generate private capital investment to support development and rehabilitation of new and rehabilitated affordable rental homes for low-income families. As the nation’s largest and most successful affordable rental housing production program, the LIHTC program has financed more than two million apartment homes since 1987 and about 120,000 annually before the recession. According to the National Council of State Housing Agencies, approximately 90 percent of all affordable rental housing is financed annually through the LIHTC. According to NAHB, until recently the program supported about 140,000 jobs annually, and benefitted local economies from the addition of $1.5 billion in taxes and other revenues. LIHTC properties are also managed very well, with an extremely low annual foreclosure rate below 0.1 percent, according to an exhaustive study by Ernst & Young.

A great deal of the LIHTC’s effectiveness comes from the nature of its public-private partnership. States administer the LIHTC, reducing federal administrative costs substantially. Each state receives an annual allocation of tax credits based on its population. The amount is $2.10 per capita (or $2.4 million for small states) in each state for 2010, amounting to roughly $650 million available in 2010 credit authority. The cap is indexed to inflation. As a result of the huge need noted above for the kind of affordable rental housing the LIHTC makes possible, demand for LIHTC far exceeds supply, i.e., many developers seeking LIHTC financing do not receive any.

States award tax credits to developers under a public, competitive process in accordance with annual plans states develop with public input that reflect their affordable housing needs. These plans are required by statute to give preference to developments serving the lowest income tenants, developments that serve income-qualified tenants for the longest periods, and to developments in distressed areas that are part of a community revitalization plan. States subject applications for LIHTCs to multiple rigorous reviews and are required to allocate only as much LIHTC as a proposed development needs to be financially viable. Investors with money at stake also intensively review and monitor LIHTC properties. Strong oversight and accountability enforced by the private sector is a distinguishing feature of the LIHTC. This is a function of its structure as a tax provision, and unlikely to be replicable in capital grant programs. In addition, since investors can claim the credit only as units are completed and occupied by qualifying tenants, the private sector takes all the development and marketing risk associated with the credit, whereas in a capital grant program, the government takes that risk.

States are also required by law to ensure that LIHTC apartments are in good condition and in compliance with tenant income and rent rules for at least 30 years. States report instances of noncompliance to the IRS, which has the ability to recapture tax credits. The GAO found that LIHTC apartment rents were well below market rents (on average 25 percent less than the HUD’s national “fair market rent”) and that LIHTC properties were well maintained.

We would also like to point out that the LIHTC leverages other private capital in addition to investor equity. The LIHTC was specifically designed not to provide the entire amount of financing; the LIHTC leverages private debt to cover much of the total development costs of LIHTC housing.

Some critics have asserted that LIHTC properties are disproportionately located in high-poverty areas. Rather than a defect of the LIHTC or divergence from congressional intent, this fact is largely a result of the housing needs assessment plans that states develop to encourage development in those communities that often have the most acute affordable housing needs. Not only has the LIHTC provided homes which otherwise would not have existed in those areas, but it has also helped revitalize those neighborhoods. An extensive analysis of LIHTC developments nationwide found the following:
Overall roughly half of the properties in the sample were developed primarily to serve neighborhood improvement goals. The vast majority of these were developed by nonprofit sponsors and undertaken to address a specific problem site in the neighborhood. Regardless of motivation, roughly two-thirds of the properties could be said to have had a substantial, positive impact on their neighborhoods.\(^5\)

The remaining properties were found to have a moderate revitalization impact and some were in neighborhoods that did not need significant revitalization.

Furthermore, LIHTC investment in high-poverty areas has helped bring families out of poverty and given them more economic opportunity, while improving the economic condition of their neighborhoods. A recent study analyzed the effects of LIHTC housing on tenant income and home prices in neighborhoods located near all 660 New York City tax credit developments built between 1987 and 2003. The study found that LIHTC tenants increased their monthly discretionary income by $500 compared to tenants in market-rate housing in the neighborhood, more than doubling it and enabling LIHTC tenants to pay for health care and other important family needs.\(^6\) This report also indicated that LIHTC properties provided an immediate and lasting boost to total surrounding property values of as much as $22 million, leading to about $1.2 million in additional property tax revenue annually.\(^7\)

### Efficiency

The LIHTC is efficient by a number of metrics as well. First, as noted above, the annual amount of LIHTCs is capped and tied to population growth and inflation. Only developments that most effectively meet state-determined affordable housing needs and undergo rigorous underwriting and review are even eligible to receive credit allocations. Then, taxpayers may only claim the credits, at the risk of recapture by the IRS for 15 years, if LIHTC-financed developments remain affordable to qualified low-income renters and in good condition for the long term.

Second, taxpayers cannot simply claim LIHTCs as they can many other tax benefits. They must obtain them in a highly competitive marketplace. Developers that receive LIHTC allocations sell them to financial institutions and other corporations (individual taxpayers account for a very small fraction of the market). The more that investors pay for the tax credits, the more public benefit the government realizes for the tax expenditure. Strong “purchasing power” for the LIHTC (efficiency for the federal government) also makes the credit more effective at achieving its public purpose. Although the recession caused LIHTC equity pricing to drop from 2009 through early 2010, pricing over the last several months has already recovered considerably.

### LIHTC in comparison to Housing Choice Vouchers

The PERAB report notes that “some experts suggest other federal aid (like housing vouchers) would assist low-income households at a lower cost” than the LIHTC. Given that the LIHTC finances the construction and rehabilitation of affordable rental housing, the upfront cost per unit of the LIHTC compared to vouchers may be higher, it is far less clear over the long term whether the costs are greater, because the effect of the LIHTC financing is to permanently reduce the rental income needed to maintain an affordable unit. Indeed, in tight rental markets, where it is often very difficult to find housing that accepts vouchers in the first place, and where the voucher outlay per month for a conventionally financed unit would be fairly high, we believe that the LIHTC often costs much less than vouchers.

However, both programs are crucial to addressing the nation’s affordable housing needs and indeed, when combined, complement each other’s strengths to solve the nation’s toughest housing challenges. The Housing Choice Voucher (voucher) program is an extremely important federal housing program that we strongly support. It provides affordable housing choices to low-income families especially well in low-cost housing markets. However, it is not a replacement for the LIHTC, which produces far more capital for affordable housing.
production than the voucher program, and creates a long-term affordable housing stock for the community. Likewise, the LIHTC, as a capital subsidy, cannot on its own ensure apartments are affordable to the very lowest income renters. LIHTCs and rental subsidies like the voucher program are often used together, to address respective problems: the LIHTC to bring down the cost of the unit (on a long-term basis), and the voucher to enable that already low-cost unit to be affordable to the lowest income tenants (and at a much lower cost per voucher than if that same tenant rented in a conventional unit with a much higher rent).

Conclusion

As a federal tax expenditure, the LIHTC in and of itself cannot be said to enhance tax code simplicity. As a practical matter, however, the LIHTC is relevant only to entities with a stake in its public purposes and, as noted above, has evolved into a highly effective, efficient program for its users and beneficiaries. Congress consciously chose to create the LIHTC as part of comprehensive tax reform and voted in support of it on a bipartisan basis as recently as 2008 in the Housing and Economic Recovery Act to modernize the program, helping it to address an even wider range of the nation’s affordable housing needs.

We would also like to note that the Administration has stated its intent to rebalance federal housing policy away from its heavy emphasis on homeownership, which is most evident in tax policy. As many Administration officials have pointed out, rental housing is important too, especially for people not yet able or ready to buy. The deduction for home mortgage interest, which mostly benefits upper income homeowners, will cost the government $120 billion in 2011 and $573 billion between 2009 and 2013.\textsuperscript{8} The LIHTC, which serves very low-income renters, will cost $5.1 billion in 2011 and $30 billion between 2009 and 2013\textsuperscript{9}—only 5 percent of the cost of the mortgage interest deduction over that period.

Some of the signature strengths of the LIHTC summarized above are functions of the LIHTC’s existence in the tax code. These include private sector underwriting, oversight and monitoring; competitive market-based pricing; high efficiency for the federal expenditure with low administrative costs; and powerful penalties for non-compliance, which ensure that taxpayers do not bear the costs of non-compliance. These attributes are not commonly associated with government spending programs.

The major elements that have made the LIHTC successful are present in the New Markets Tax Credit (NMTC), originally enacted in 2000. The Administration’s FY 2011 budget proposes to extend the program through 2011. The NMTC stimulates commercial, manufacturing, real estate, and small business activities in distressed communities. It is based on the same fundamentals that have made the LIHTC public-private partnership so successful.

Since its inception, $26 billion in NMTC authority has been allocated to Community Development Entities (CDEs). This has led to more than $18 billion in private capital raised to support more than 15,000 businesses, helped to develop or rehabilitate over 68 million square feet of real estate, and created almost 400,000 jobs in low-income communities and targeted for low-income populations. According to the Treasury Department, every $1 in foregone tax revenues under the NMTC leverages about $12 of private investment in distressed communities. Also, the cost of creating a job in a low-income community under the credit is less than $18,000.

We urge the Commission to account for the importance of using tax policy on a carefully targeted, low-cost basis to help ensure that the broader economic system works for low-income people and communities.
Endnotes

1 General Accounting Office, Tax Credits: Opportunities to Improve Oversight of the Low Income Housing Program, March 1997, p. 22.

2 Ibid., p. 41.

3 National Low Income Housing Coalition, September 2010.


6 Walker, Christopher, Affordable Housing for Families and Neighborhoods: The Value of Low Income Housing Tax Credits in New York City, June 2010.

7 Ibid.

8 Joint Committee on Taxation, Estimates of Federal Tax Expenditures for Fiscal Years 2009-2013, p. 33.

9 Ibid.