

# Tax Reform and the Low-Income Housing Tax Credit

## *Comments of the Affordable Housing Tax Credit Coalition<sup>1</sup>*

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In the past several months, the President's Advisory Panel on Federal Tax Reform (the "Panel") has heard from many experts, practitioners, and taxpayers about the complexities, unfairness, and/or problems within the tax code and has recently begun to hear suggestions of changes to the code. The Panel was tasked with submitting a report with tax reform options that: (a) simplify Federal tax laws to reduce the costs and administrative burdens of compliance with such laws; (b) share the burdens and benefits of the Federal tax structure in an appropriately progressive manner while recognizing the importance of homeownership and charity in American society; and (c) promote long-run economic growth and job creation, and better encourage work effort, saving, and investment, so as to strengthen the competitiveness of the United States in the global marketplace.

In developing its recommendations, the Panel should not look at the tax code in isolation. Instead, the Panel should consider the overall impact of certain reform proposals, including unintended consequences, on important Federal programs, such as the Low-Income Housing Tax Credit (the "Housing Credit") program.

The Housing Credit program is the most significant Federal financial resource for the production of affordable rental housing for America's low-income families. Without the rental housing that the Housing Credit provides, America's housing crisis will worsen significantly and the major economic stimulus the Housing Credit provides for jobs and growth will be lost. Tax incentives have proven to be the most efficient way to create affordable housing and the Housing Credit, which draws upon cooperation between states and the private sector, is one of the few areas in which use of the Internal Revenue Code to meet social goals is vital and has no viable alternatives. Any tax reform adopted must be structured to avoid harming this very successful program.

### **Background of the Housing Credit**

Originally signed into law as part of the Tax Reform Act of 1986, the Housing Credit is responsible for the production of up to 50% of all multifamily housing starts in any given year, and virtually all affordable rental housing in the United States since that time—over 130,000 dwelling units annually and more than 1.7 million units since

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<sup>1</sup> The Coalition is a trade organization based in Washington, DC comprised of most of the major private sector participants in the Low-Income Housing Tax Credit program. Its members are syndicators, institutional investors, for-profit and not-for-profit multifamily developers, lenders, and public agencies (including those which allocate Low-Income Housing Tax Credits). Coalition members are responsible for the vast majority of the six billion dollars invested annually in affordable rental housing properties. We appreciate this opportunity to share our views with the Tax Reform Panel.

enactment. The program is also responsible for an estimated 167,000 jobs each year associated with the creation of housing.

The Congress understood from the beginning that private capital could only be attracted to affordable housing if there were tax benefits to replace the cash flow typically paid to real estate investors. The program is a model of effective use of public resources, leveraging taxpayer dollars with private capital, creating well-aligned public-private partnerships, and relying on states for administration and local priority setting. Together these factors assure that any new housing developed meets local community needs and is developed and maintained according with strict compliance rules. In 1993 Congress decided to make the Housing Credit a permanent program. Its longevity is testimony to the fact that the program has operated as intended. The program enjoys widespread and bipartisan congressional support—in 2000, legislation to increase the amount of Housing Credits was co-sponsored by 85% of the Congress, with almost equal numbers of Republicans and Democrats.

### **How the Housing Credit Works**

The program provides tax incentives, in the form of credits against federal income tax, in exchange for investment in newly constructed or substantially rehabilitated affordable rental housing. For periods of 30 years or more, this housing must serve low to moderate income tenants, who pay restricted rents and who earn a maximum of 60% of area median income (although average incomes in these properties are often far lower). Credits are allocated to the several States based upon their respective population. The States determine their own housing priorities, within broad federal guidelines, and then choose which proposed developments will receive Housing Credits. Developers, many of which are non-profit organizations, must compete for Housing Credit allocations under a highly transparent selection process. In most States, demand for Housing Credits far exceeds the supply, even with the increase authorized in 2000. Developments which are awarded Housing Credits are located in urban, suburban and rural areas. Although a majority of the properties serve families, a substantial number serve elderly, disabled and special needs populations.

Once the Housing Credits are awarded to a housing developer, investors provide equity capital to finance a substantial portion of the costs of constructing or rehabilitating the housing. This equity capital reduces the need for mortgage financing and decreases debt service payments, thereby lowering operating costs and allowing owners to rent to low-income persons who pay rents they can afford.

Approximately 98% of this equity capital is raised from corporations, including banks, financial institutions, insurance companies, and Government Sponsored Enterprises. Investors have invested nearly fifty billion dollars since 1986. Due to the passive loss limitations and alternative minimum tax limits, individual investors supply very little capital and thus cannot compensate for any reduction in corporate investment. Even if the passive loss and alternative minimum tax rules were to be substantially modified, raising capital from individual investors is far less efficient because individuals cannot be expected to make commitments at the levels which corporations invest, which are typically in the tens of millions of dollars.

It is important to note that the prices which corporations are willing to pay for Housing Credits have risen dramatically over the past ten years, which translates into more equity available to build affordable housing. Prices began to rise after the Congress made the Housing Credit program a permanent part of the Code in 1993 because investors became confident that the program would exist for the long term. Indeed, prices have risen by approximately 50% in the past ten years, meaning that each tax credit dollar brings in more private capital, increasing the program's efficiency.

Housing Credits are earned over a 10-year period, although they are subject to recapture for 15 years if various program rules are violated. Accordingly, corporations are highly motivated to make sure that the Housing Credits are received and not lost to recapture. Many corporations engage firms with special expertise in this area, often referred to as Housing Credit syndicators, to help them in structuring and monitoring the properties. This very intense oversight and the effective administration conducted by States are the principal reasons that the program has operated in accordance with government requirements—and even exceeded expectations—throughout its history. The threat of the severe penalty of tax credit recapture (which penalty only available through the tax code) serves to keep the program operating as Congress intended.

### **The Housing Credit is Critical to Addressing America's Unmet Affordable Housing Needs**

In the United States, approximately one-half of our lowest income families spend 50% (or more) of their income on housing. Indeed, the Joint Center for Housing Studies estimates that we need more than 5 million rental units to meet America's need for safe, affordable housing. Affordable housing development simply cannot be financed without the private capital attracted by the credit. HUD subsidies and other programs do not provide sufficient resources to encourage the development of affordable housing. For example, housing vouchers would not provide upfront assistance to build housing developments, nor would they address issues of rehabilitating old housing. Prior to the enactment of the Housing Credit there was insufficient production of affordable rental housing. Furthermore, the States do not have the resources to provide something on the scale of the Housing Credit.

The Housing Credit is also a driver in the revitalization of lower income communities. Through the Housing Credit, private capital is used to reverse the cycle of decline. The Housing Credit has turned around neighborhoods and stabilized the urban core while these regions are growing at the periphery. The Housing Credit also contributes to recapitalization of existing housing and can be used to address special needs housing, such as housing for the elderly, formerly homeless, and special needs populations.

It is estimated that 200,000 affordable units are converted to some other use (such as market rate rental housing, condominium conversion or demolition) each year. The Housing credit accounts for construction of 130,000 new units each year. Thus, the Nation continues to lose ground, even with the success of the Housing Credit. The affordable housing deficit will inevitably escalate if the Housing Credit program is eliminated or adversely affected by tax reform.

## **The Tax Code is the Best Way To Meet the Nation's Affordable Housing Needs**

A housing production program like this cannot be set up anywhere other than the tax code because tax recapture is not available in any spending program. There is no effective real estate collateral that can act as a penalty. The Housing Credit program provides for tax credit recapture in cases where there is evidence of non-compliance with program rules. The threat of recapture has acted as a powerful compliance mechanism that spending programs simply cannot replicate.

## **The Housing Credit Provides Economic Stimulus**

More and more working families need affordable housing. The Congressionally-appointed, bipartisan Millennial Housing Commission stated last year that the evidence is "mounting that stable, affordable rental housing plays an important role in helping families find and hold jobs."

The Tax Reform Panel has been asked to provide proposals that are pro-growth. It would be tragic and ironic if this tax reform proposal, intended to stimulate growth, undermined the Housing Credit program, which itself serves as a powerful economic stimulus. Based on figures extrapolated from a study conducted by the National Association of Home Builders, each year the construction and ongoing operation of Housing Credit properties generates approximately \$8.8 billion of income for the economy, creates 167,000 jobs, and produces \$1.35 billion of revenue for cash strapped local governments. In short, maintaining the Housing Credit is consistent with the President's pro-growth directive.

## **Proposed Solution**

We understand that concern has been raised that if protection of the Housing Credit is secured, then advocates for other credits and tax preferences will seek similar treatment. While we are not opposed to treating other credits in a like manner, our principal concern involves the Housing Credit. The Congress has historically singled out the production of affordable housing for special treatment. In 1986, at the very moment that tax reform was enacted to, among other things, shut down most tax-advantaged investments, the Congress and the Administration recognized the need to continue to provide incentives for affordable rental housing, and created the Housing Credit program in response. In 1993, the Congress made the Housing Credit permanent, singling it out among a number of other credit programs. The current Administration has also recognized the appropriateness of encouraging certain behavior through the tax code. Logical distinctions between the Housing Credit and other preferences can and should be made. We therefore urge the Panel to include preservation of the Housing Credit in any tax reform proposal it sets forth.

***No matter what reform is adopted, the Low-Income Housing Credit program, must be preserved. Preserving the Housing Credit program is consistent with the President's goals and is critical to ensuring the production of, and access to, safe, affordable rental housing.***

## **Preserving the Housing Credit program is FAIR**

By recognizing the importance of the Mortgage Interest Deduction, the President has already acknowledged that, in certain instances, it is appropriate to use the tax code to shape social policy, and in particular, housing policy. Approximately 90% of the benefit of the Mortgage Interest Deduction is realized by taxpayers with annual income of \$50,000 or more. In addition, the tax code currently does (and should continue to) provide a tax program that helps lower-income families afford safe, quality housing. Furthermore, the Housing Credit program is transparent and transactions are easily tracked.

## **Preserving the Housing Credit program is SIMPLE (not complex)**

The Housing Credit is a product of the 1986 Tax Reform Act in which the objective was to simplify the tax code and remove incentives. Congress looked at previous incentives and decided that, in the case of meeting the Nation's affordable housing needs, a tax incentive was necessary. The Housing Credit is regarded as less complex than the combination of tax incentives and housing programs that preceded it.

The Housing Credit has proven to be the most efficient and effective way to meet the Nation's affordable housing needs. Internal Revenue Code Section 42 sets forth a detailed list of rules which taxpayers must follow in order to be entitled to claim the Housing Credit. These rules make compliance and enforcement more straightforward. They allow the program to be maintained through a more reliable combined state and federal audit system. The result is that more taxpayer dollars go toward providing affordable housing and less to bureaucratic supervision. Repealing the Housing Credit would only make the tax code shorter, not simpler. However, eliminating the credit would tremendously complicate the lives of the individuals and families who reside in the tax credit developments, with no noticeable reduction in IRS burden.

## **Preserving the Housing Credit program is PRO-GROWTH**

Housing construction and rehabilitation leads to creation of new jobs and often drives additional development. Increased jobs and sales could lead to a rise in property tax values that raise revenues in cities and towns. Increasing permanent, quality, affordable housing can also save states and localities millions of dollars in reduced emergency care for the homeless, and avoids blight and deterioration in the country's housing.

## **Preserving the Housing Credit program is the right thing to do**

Without the Housing Credit, communities are likely to deteriorate and no one will monitor where affordable housing is needed most. Elimination of the Housing Credit program would leave families without safe, quality, affordable housing. The affordability gap would continue to increase at an even faster rate and families and seniors will find it even harder to meet their housing needs.