ANALYSIS OF FACTORS AFFECTING LIHTC RENTAL HOME PRODUCTION 1997-2014

The number of rental homes financed and produced by the low-income housing tax credit (LIHTC) has changed over time. There are a number of factors that affect LIHTC home production. This discussion considers several factors from 1997 to 2014, the last year for which complete data is available, to analyze production over time. The analysis shows that the production differences between 1997 and 2014 can be largely explained by the factors outlined in this paper.

Higher construction costs

One of the main factors affecting production is the change in construction costs. One industry-accepted index that measures the cost of construction over time is from RSMeans. LIHTC allocations per home must be increased to bear these increased construction costs. Taking into account the RSMeans index to adjust the number of homes produced and account for the estimated 82 percent increase in the cost of construction from 1997 to 2014 reduces the estimated homes produced by 52 percent, an estimated loss of 36,600 homes.

Adjusting Number of Affordable Rental Homes in 1997 to Account for Current Economic and Market Factors

	# of rental homes
Total rental homes reported in 1997 by the National Council of State Housing Agencies (NCSHA)	**70,220**
Increase in construction costs (52%)	- 36,600
Increase in equity price (26%)	+ 8,872
Increase in tax credits (103%)	+ 43,608
HOME and CDBG (-15%)	-13,148
HOME (-6,306)	
CDBG (-6,842)	
Deeper income skewing (-20.83%)	- 17,937
Changes in NOI (0.66%)	+ 568
Total Adjusted 1997 rental homes	**55,583**
Total rental homes reported in 2014 by the National Council of State Housing Agencies (NCSHA)	**58,735**

Source: National Council of State Housing Agencies (NCSHA); Novogradac & Company LLP

Equity pricing

One factor enabling greater housing production since 1997 has been the increase in the amount investors contribute as equity for LIHTC allocations. When the LIHTC was made a permanent part of the tax code in 1993 and when the Community Reinvestment Act regulations were promulgated in 1995, LIHTC investors responded over time to increase demand for LIHTC equity and the price paid for each tax credit dollar. In 1997, the national median equity price for LIHTC equity was approximately 72 cents per tax credit dollar; in 2014, the price increased to approximately 91 cents per tax credit dollar. Taking into account increased equity pricing adjusts estimated homes produced by 26 percent when applied to the 1997 adjusted amount, an increase of 8,872 homes.

Additional tax credit authority

Another factor positively affecting housing production was the greater amount of LIHTC authority available in 2014 than in 1997. From 1987 to 2000, each state received $1.25 per capita or $2 million, whichever was greater, in annual LIHTC authority. As the population increased from 1987 to 2000, so did the amount of LIHTC authority. In 2000, Congress passed legislation increasing annual allocation per-capita authority to $1.50 in 2001 and $1.75 in 2002, and then authorized annual inflation adjustments in 2003 and thereafter. In 2014, the per-capita amount was $2.30 and the small-state minimum was $2.6 million. Taking the increased authority from population and inflation into account adjusts estimated homes produced by 103 percent, an increase of 43,608 homes.

Less Federal "soft" subsidy

In addition to LIHTC equity and mortgage debt, developments often need financing from other sources—often referred to as gap financing or "soft" subsidies—to be financially feasible. Two of the largest sources of soft subsidies from the federal government are HOME Investment Partnership (HOME) and Community Development Block Grant (CDBG) funding. As the allocation authority and tax credit pricing were rising, HOME and CDBG did not keep pace. Since 1997, in fact, both HOME and CDBG funding, in nominal terms, have actually been cut. With less soft subsidies available, in absolute and proportional terms, development funding must depend more heavily on LIHTC equity. Taking into account absolute and proportional lower available federal soft subsidies reduces estimated homes produced by 15 percent, or 13,148 homes (HOME 6,306 and CDBG 6,842).

Deeper income targeting

Another factor affecting production has been deeper income targeting in LIHTC developments. Two of the preferences required by the LIHTC statute are to serve the lowest income populations, and to do so for the longest period of time. From 1997 to 2014, median incomes of LIHTC tenants dropped from an estimated 40 percent of the area median to an estimated 30 percent. Deeper income targeting means lower rents, which requires lower debt service. The reduced debt is supplanted with increased LIHTC equity. Taking into account deeper income targeting reduces estimated homes produced by 21 percent, or 17,937 homes.

Change in net operating income

Lastly, operating costs in LIHTC developments have also changed since 1997. Net operating income (NOI) measures rental income based on area median incomes minus operating expenses. Estimated operating expenses of LIHTC developments have slightly outpaced estimated area median incomes, but since rental income is larger than operating expenses, net operating income is still estimated to increase about 2 percent. Taking into account the small estimated increase in NOI bumps up estimated homes produced by 0.66 percent, an increase of 568 homes.

Other factors

Below is a partial list of other factors that are known to affect housing production, but for which available data is insufficient to adequately estimate the national impact:

- Change in affordable housing funding from state and local governments (one example would be the loss of $1 billion annually from local redevelopment agencies in California)
- Application of prevailing-wage requirements to LIHTC developments (some states had already required prevailing-wage requirements by 1997, others had yet to do so)
- Changes in state tax credit programs
- Increased cost of additional amenities (e.g., common areas for supportive services, community rooms, etc.)
- Increased upfront cost of meeting green building and sustainable development practices
- Increased cost of land, particularly in high-opportunity areas
- Interest rate changes (affecting amount of mortgage debt service)

Conclusion

After making the adjustments outlined in this paper, the estimated production in 2014 is 55,582 homes. In 2014, the LIHTC produced 58,735 homes, about 106 percent of the estimated amount.