Critiquing the Critique: Analyzing a Report on the Housing Credit Program

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Executive Summary
The federal low-income housing tax credit ("LIHTC") is the largest production resource for affordable rental housing. Advocacy groups have critiques of the program's administration, but a recent study used to support their arguments contains multiple problematic deficiencies.

In evaluating this report the article also discusses racial desegregation, concentrating poverty, preservation, community revitalization, and other related housing policy issues. The conclusion is that those researching the LIHTC program should communicate with state administrators in order to avoid analytical flaws.

Introduction and Purpose[1]
The following quote is taken from an amicus brief submitted to United States Supreme Court as part of the Seattle and Louisville school desegregation cases[2]:

> A recent report found that "very few states are placing more than half their LIHTC family units… in census tracts with lower minority population rates than the metropolitan area average." In both the Seattle and Louisville metropolitan areas, with minority population shares of approximately 24% and 18%, respectively, more than 68% of LIHTC family units were located in census tracts with greater than average minority population shares between 1995 and 2003.

The report cited is *Are States Using the Low Income Housing Tax Credit to Enable Families with Children to Live in Low Poverty and Racially Integrated Neighborhoods?* (2006),[3] referred to herein as the "Report"; it was prepared by Abt Associates, Inc. for the Poverty and Race Research Action Council and National Fair Housing Alliance.

The advocacy groups responsible for the amicus brief, and others who use the Report for similar purposes,[4] have a problem: the analysis is not adequate to support its conclusions. The unfortunate necessity served by this article is an explanation of these shortcomings.

Ideally for everyone involved, the basis for the advocates' charges could remain unchallenged. Every year the state and local agencies that allocate LIHTCs ("allocating agencies") actively solicit criticism of their policies. Even small jurisdictions receive many dozens of comments annually. None of these statements, no matter how negative, merits a 2,500 word published response.

But the claims of these advocacy groups are fundamentally different, and the potential stakes are higher. A full explanation of their agenda is beyond the scope of this article (although it is readily available on the Internet).[5] In summary, their goal is to make the case that allocating agencies' administration of LIHTCs does not comply with federal law.[6]

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The advocates' hoped-for remedial measures include additional mandates from Congress, the Internal Revenue Service ("IRS"), and Department of Housing and Urban Development ("HUD"). These new requirements could have unintended negative consequences for allocators, properties, and residents.[7] Other interested parties do not claim illegality in their comments and almost never seek additional federal impositions.

A more important reason for not describing the advocates' position here is that this article does not prove the absence of the problems they claim exist. Rather, its purpose is to raise the level of dialogue. Without these comments, the Report would be the last word on this issue. In reality it's barely a beginning. Advocates and agencies actually have a great deal in common, but inaccurate and unfair characterizations such as those in the Report impede progress towards shared goals. Balanced, fact-based discussions are a prerequisite to meaningful change.

Background on LIHTCs and the Report

A proper description of LIHTCs is even further beyond the scope of this article, but fortunately there are many descriptions available on the Internet.[8] The following is a much abbreviated summary:

- The governing statute is the Internal Revenue Code and the federal administrator is the IRS (not HUD).
- Allocating agencies are responsible for implementing the program, including allocation and compliance. The rules for these processes are contained in Qualified Allocation Plans.[9]
- Large institutional investors place equity into qualified properties. For example, a 56 unit property generates $4,700,000 in credits over 10 years. In exchange for this dollar-for-dollar reduction in tax liability, the investor provides $4 million in equity (amounts vary). This covers approximately 70 percent of the costs and greatly reduces the amount of debt financing necessary.
- Units are rented (none are owner-occupied). To be eligible for LIHTCs, units must be affordable to and occupied by households at 60 percent of area median income.
- Each year LIHTCs are awarded to build or rehabilitate 130,000 units across the country, and there are over 2 million nationwide.[10]

The Report attempts to identify the extent to which states are using LIHTCs to develop family housing in low poverty and racially integrated portions of large metropolitan areas. To answer these questions, the authors geocoded projects with two or more bedrooms that were placed in service between 1995 and 2003.[11] The Report's definition of metropolitan areas is those with populations greater than 250,000, and a low poverty neighborhood is a census tract in which fewer than 10 percent of the residents live in households with incomes below the poverty line.[12] For their analysis of racial patterns, the authors compared "the minority population rates of the locations of LIHTC family housing within each state's large metropolitan areas to average minority population rates for those areas."[13]

Based on these assumptions, the Report has reached conclusions such as the following: "Patterns within regions show that some states appear to focus on [using LIHTCs in low poverty areas] considerably more than do adjacent states."[14] Five states are identified as performing poorly for concentrating both race and poverty.[15]

Problems with the Report
The following are the most important limitations in the Report's analysis.

1. Including rehabilitated units
The Report uses words such as "placed," "located," or "produced" to describe how allocating agencies have used LIHTCs in areas of concentration. [16] These words clearly imply newly constructed projects that increase an area's population. Of course that is not just an implication but inherent to the advocates' claim that allocating agencies are exacerbating the problems of concentration.

However, in making their calculations, the authors do not differentiate between creating new units and rehabilitating existing ones. According to the Report, apartments that have been occupied for decades are "placed," "located," or "produced" in concentrated areas because of using LIHTCs to make physical improvements. In other words, replacing cabinets in a 100 unit project is counted as having the same effect on concentration as building new housing for 100 families.

Not only is this methodology counterintuitive, it skews the results.[17] Over half of the LIHTC units placed in service between 1995 and 2003 in the Seattle metropolitan statistical area ("MSA"), and nearly 40 percent of those in Louisville, were in pre-existing projects rehabilitated using LIHTCs.

Even a pro-rata split between new construction and rehabilitation would reduce the 68 percent "located" figure cited in the amicus brief down to 32 percent and 41 percent, respectively.[18] But the distribution of allocations to new and rehabilitation projects is generally not pro-rata; the latter are more likely to be in areas of concentration. Indeed, many of the properties that are being physically improved with LIHTCs already contribute to the low-income concentration. Therefore the percentage of units actually added to areas of concentration in these two cities may be even less than the percentage of the MSA population that is minority. At a minimum, the problem these advocates identify and subsequently present to the Supreme Court is substantially less severe than indicated.

The effect of not distinguishing new construction units from rehabilitated ones runs throughout the Report. Of the five states critiqued for performance in both poverty and race, 56 percent of the total units covered are in rehabilitated projects:

	rehab	total	percent
D.C.	6,248	6,725	92.9%
Mass.	13,714	17,278	79.4%
Conn.	4,192	5,700	73.5%
Illinois	10,241	22,820	44.9%
Arizona	1,489	11,539	12.9%
TOTAL	35,884	64,062	**56.0%**

The first three jurisdictions listed above are particularly compelling. The Report critiques the work of these allocating agencies as exacerbating the problems of concentration, when in fact less than 20 percent of all LIHTC units were newly constructed. The remaining housing was already there, and now the residents have an improved physical environment.

Furthermore, a substantial proportion of the new units may have been built outside of concentrated areas. One researcher reached that very conclusion:

> By and large, the program seems to be placing LIHTC new construction units in low-poverty tracts in at least roughly the same proportion as all LIHTC units, and most states are placing a disproportionate share of their LIHTC new construction units in low-poverty tracts.[19]

Lastly, the advocates' premise also fails to account for the intrinsic value of rehabilitation: making existing conditions better and ensuring that affordable apartments are not lost to deterioration or market forces.[20] Preservation can only occur where the properties exist, not where theorists may prefer.

2. Not counting the net effect of replacement housing

During the time period of the Report's analysis, federal, state and local governments have redeveloped a large amount of distressed subsidized housing. HOPE VI is the largest single program for redevelopment and is typical of the most frequent pattern: replacing obsolete apartments with mixes of incomes (i.e. from zero-income to market rate), tenures (i.e. rental and ownership), and uses (i.e. residential and commercial).

The federal investment has been substantial:

> Since 1992, HUD has awarded 446 HOPE VI grants in 166 cities. To date, 63,100 severely distressed units have been demolished and another 20,300 units are slated for redevelopment.[21]

The eventual outcome is almost always a reduction in the number of low-income households in the immediate vicinity. Indeed, one of the official goals of the HOPE VI program is "[l]essening concentrations of poverty by placing public housing in nonpoverty neighborhoods and promoting mixed-income communities."[22]

Another of HUD's goals for HOPE VI is to leverage other resources. As a result, three-fourths of HOPE VI project phases involve LIHTCs.[23] (Some of the other phases are for homeownership and thus not eligible for LIHTCs.) The work of the housing authority in Louisville fits this description. In 1996, HUD awarded $20 million to redevelop over 700 units of public housing. An aspect of this work was to build at least 300 new LIHTC units.[24] There is little doubt that all of these new units were located in areas of concentration.

As a result, the Report counts the 300 LIHTC apartments as "placed," "located," or "produced" in areas of concentration, when they are in fact partially or completely replacing over 700 units of public housing. The reality is a net reduction of approximately 400 units for low-income families. This housing represents 17 percent of the new construction counted in the Report. Removing both these 300 HOPE VI tax credit units and the rehabilitated units described in the preceding section would reduce the true figure in the amicus brief to 33 percent--a far cry from the advocates' 68 percent as derived from the Report's analysis.

The analytical consequences of not addressing replacement housing may be even more pronounced for other parts of the country. The five jurisdictions cited by the report were awarded $588 million in HOPE VI between 1993 and 2002. Calculating the net reduction due to redevelopment would have required a great deal of time and additional data (unlike accounting for rehabilitated units). However the authors should have clearly noted this limitation as a caveat to the Report's conclusions. Failure to do so was a problematic omission.

3. Available and appropriate sites
There are three related factors outside the control of LIHTC allocating agencies that contribute to creating concentrations. They are functions of federal law, local decisions, and the marketplace.

Land is a major factor in siting LIHTC projects since its cost is not subsidized.[25] Dollars spent on land must be covered by loans, and tenant rent pays the resulting debt service. Thus, higher land costs mean reduced cash flow and/or less affordability (each to the extent allowed under program rules). Since the market value of land generally has a negative correlation with the percent of area households in poverty, the inherent math of project feasibility encourages sites in low-income areas.

Finding real estate that is not too expensive for affordable housing is only part of a developer's challenge. Uses permitted under local land regulations are another. Higher income neighborhoods often object to any type of apartment development, let alone those for low-income families. The political reality in some jurisdictions is that LIHTC projects can be sited either in areas of relative poverty or not at all.

Regardless of land costs and uses allowed by zoning, not all areas of a city make sense for low-income rental housing. Residents of LIHTC projects need convenient access to employment, mass transit, shopping, amenities, and services at least to the same extent as occupants of market-rate apartments, if not more so. This consideration is even more important for particular targeted populations, such as the formerly homeless. Locations that work well from a practical, real estate perspective simply are more likely to be in census tracts with higher densities and higher poverty, not in rural areas or sprawling suburbs.

Finally, even if none of the above were factors, the preference of particular project sponsors often drives the location of LIHTC projects. Many developers are community-based nonprofit organizations that include housing as part of an overall mission of service. While a good nonprofit can add value anywhere, many see a greater opportunity to have an impact in low-income neighborhoods. As a result they are more likely to undertake projects in areas of concentration.[26] One commentator recognizes that following the advocates' agenda means "the structure of many community development corporations would need to change."[27]

4. Statutory preference for Qualified Census Tracts
The federal law governing LIHTCs has two related provisions that actually have the effect of increasing concentrations; both involve housing located in Qualified Census Tracts ("QCT"). Census tracts become "Qualified" if at least half or more of households' incomes are less than 60 percent of the area median gross income or if the poverty rate is at least 25 percent.[28]

The first incentive is financial: projects in QCTs may generate up to 30 percent more LIHTC equity. The effect is to reduce the amount of debt financing, which in turn increases cash flow and makes the project more feasible and attractive to developers. The public benefit is lower rents and deeper income targeting.

The other provision is regulatory: allocating agencies must give preference to projects that contribute to a community revitalization plan and are located in a QCT.[29] Therefore, all else being equal, an application meeting these criteria will be funded over a competing proposal outside of a QCT.

These aspects of the IRS Code have the same effect on the location of LIHTC projects as the lack of subsidy for land costs. All are functions of how Congress created the LIHTC program, as opposed to choices made by state or local policy makers.

Conclusion
Allocating agencies agree with the advocates' fundamental goal of deconcentration. However, being experienced practitioners means learning that actions based on good intentions sometimes lead to negative unintended consequences. The following are possible outcomes of policies that could be adopted in response to the Report:

- not rehabilitating units for low-income residents;
- not participating in community redevelopment efforts;
- awarding projects that are less affordable due to high land costs;
- substantially increasing developers' challenges in finding sites;
- diminishing the role of community-based nonprofits; and
- in general, not building new apartments in jurisdictions with a serious need for affordable housing.

Any of these would be unfortunate, particularly if premised on incomplete or faulty analysis.

One of the primary reasons for the Report's shortcomings is a lack of communication with allocating agency staff, which is a frequent phenomenon among academic researchers. The process of LIHTC administration is extremely complex and difficult to understand. Failure to directly engage those who implement the program will almost invariably result in debatable analysis.

Replacing the current one-sided critique with a cooperative, constructive dialogue is the best way to reach common goals. Advocates should take the approach of others who seek policy changes: reach out in good faith to program administrators, express concerns, listen to responses, and try to understand states' limitations.

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[1] All statements in this article are my (Mark Shelburne's) own personal opinions and not positions of the North Carolina Housing Finance Agency.

[2] Brief for Housing Scholars and Research & Advocacy Organizations as Amici Curiae Supporting Respondents, Parents involved in Community Schools v. Seattle School District No. 1, 127 S. Ct. 2738 (2007) (No. 05-908).

[3] Khadduri, J., Buron, L., and Climaco, C. (2006). Are states using the Low Income Housing Tax Credit to enable families with children to live in low povery and racially integrated neighborhoods? *Abt Associates Inc.* Cambridge, MA. Last retrieved online April 5, 2008: www.prrac.org/pdf/LIHTC_report_2006.pdf

[4] For an example *see* Brown, C. and Williams, S. (2007). *The houses that eminent domain and housing tax credits built: imagining a better New Orleans*, 34 Fordham Urb. L.J. 689. Last retrieved online March 16, 2008: http://law.fordham.edu/publications/articles/400flspub8506.pdf; *see also* de Leeuw, M. (2006). Residential Segregation and Housing Discrimination in the United States 8, Last retrieved April 24, 2008: www.knowledgeplex.org/showdoc.html?id=1394851

[5] The following is one knowledgeable commentator's description of the goal: "The issue of race, however, is mobilizing housing advocates in the current era of de facto segregation where 'racial hierarchy is maintained through institutional means.' Specifically, housing advocates are mobilizing around the Low Income Housing Tax Credit…." *from* Standaert, D. (2006). The absence of minority concentration assessments in the Low Income Housing Tax Credit: An empirical data case study of Durham, North Carolina. *Practicing Planner*. Last retrieved online January 27, 2008:www.prrac.org/pdf/Standaert.pdf.

[6] In a few states, making the case has involved initiating litigation. See, e.g., Asylum Hill Problem Solving Revitalization Ass'n v. King, 890 A.2d 522 (Conn. 2006); In re Adoption of the 2003 Low Income Hous. Tax Credit Qualified Allocation Plan, 848 A.2d 1 (N.J. Super. Ct. App. Div. 2004)

[7] For example, certain suggested policies may have the effect of actually increasing race-based Fair Housing violations at the project level.

[8] See www.nchfa.com/Rental/RDweoffer.aspx for a brief explanation.

[9] For more information, see Shelburne, M. (2008). An analysis of Qualified Allocation Plan selection criteria. *Journal of Tax Credit Housing,. 1(1, 1-7.* Last retrieved online January 31, 2008: http://www.novoco.com/low_income_housing/news/article_of_month/article_of_month_0108.pdf.

[10] For more information see http://www.ncsha.org/uploads/Housing_Credit_Fact_Sheet.pdf . (last retrieved April 5, 2008)

[11] This information is available at www.huduser.org/datasets/lihtc.html.

[12] See Khadduri, supra note 3, at 3.

[13] See Khadduri, supra note 3, at 4.

[14] See Khadduri, supra note 3, at 22.

[15] See Khadduri, supra note 3, at 14 and 17. Arizona, Connecticut, Illinois, Massachusetts, and Washington D.C. Other states were identified as having poor results in concentrating either race or poverty.

[16] When used in this article, the word "concentration" means both poverty and race.

[17] The following analysis essentially replicates the Report's, while also distinguishing between added units and rehabilitation. The information for this distinction is readily available in the same HUD database used by the authors.

[18] If 54% of applicable units in the Seattle MSA were rehabilitated, 46% were newly constructed. A pro-rata split of the 68% of units "located" in areas of concentration would mean that 32% of new units were in areas of concentration (46 * .68 = 32).

[19] Rengert, K. (2006). Comment on Kirk McClure's "The Low-Income Housing Tax Credit program goes mainstream and moves into the suburbs." *Housing Policy Debate, 17(3), 473-490.* Last retrieved online January 27, 2008: www.fanniemaefoundation.org/programs/hpd/pdf/hpd_1703_rengert.pdf. (quotation taken from page 482).

[20] For more information see www.nhtinc.org/documents/Why_preserve_issue_brief.pdf . Last retrieved on February 9, 2008.

[21] Popkin, S., Katz, B., Cunningham, M., Brown, K., Gustafson, J., and Turner, M. (2004). *A decade of HOPE VI: Research Findings and Policy Changes.* The Urban Institute. Retrieved online January 26, 2008: www.urban.org/publications/411002.html.

[22] U.S. Department of Housing and Urban Development. (ND). *About HOPE VI.* Retrieved online December 29, 2007: www.hud.gov/offices/pih/programs/ph/hope6/about/.

[23] U.S. Department of Housing and Urban Development. (2007). *HUD Testimony: Statement of Orlando J. Cabrera.* Retrieved online December 29, 2007: www.hud.gov/offices/cir/test052407a.cfm.

[24] These units are readily identifiable in the HUD database as being part of a HOPE VI redevelopment due to the name of the project. Other new construction LIHTC projects with different names also may have been part of the redevelopment.

[25] IRS Code Section 42 bases the amount of subsidy on depreciable items, which do not include land and certain soft costs (e.g. negotiating the partnership).

[26] Abt Associates, Inc., (2000). Assessment of the Economic and Social Characteristics of LIHTC Residents and Neighborhoods: Final Report, 4:16-4:18.

[27] Orfield, M. (November 2005). *Racial integration and community revitalization: applying the fair housing act to the low income housing tax credit*, 58 Vand. L. Rev. 1747, 1802.

[28] Internal Revenue Code, 26 U.S.C. § 42(d)(5)(c)(ii)(I).

[29] Internal Revenue Code, 26 U.S.C. § 42(m)(1)(B).