COMMENT

LEGAL OBSTACLES TO AFFORDABLE HOUSING DEVELOPMENT*

ABSTRACT

A nationwide housing shortage creates persistent housing affordability challenges for American households. As things stand today, the nation's current market-based policies in the private housing sector threaten to undermine efforts by affordable housing developers. The Low-Income Housing Tax Credit ("LIHTC") program and related housing law can—and should—be modified to allow developers to respond to systemic economic shortcomings in the housing market. This Comment explores the historical efforts by Congress and, more recently, the 2017 Tax and Jobs Cuts Act, that address, or fail to address, this severe housing shortage. By framing the obstacles faced by affordable housing developers in the context of recent changes in the tax code, this Comment aims to highlight areas where reform is desperately needed to adequately respond to America's affordable housing crisis.

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I. INTRODUCTION

Understanding the challenges faced by affordable housing developers starts with an understanding of the Low-Income Housing Tax Credit ("LIHTC") program.[1] In line with other federal policy initiatives, congressional response to the country's need for decent, safe, and affordable places to live has been in large part through the tax code.[2] The Tax Reform Act of 1986 introduced a program administered by the Internal Revenue Service ("IRS") that issues tax credits to developers who use the credits to attract private investment into housing projects that meet certain affordability criteria.[3] The LIHTC program itself has not changed substantially since it was rolled out in 1986, but it has grown vastly in importance to the real estate

1. I.R.C. § 42 (2012).
2. *See infra* Section II.B (explaining the creation of the LIHTC program).
3. *See* Tax Reform Act of 1986, Pub. L. No. 99-514, § 252, 100 Stat. 2085 (codified as amended at 26 U.S.C. § 42 (2012)).

market in the past few decades.[4] This is especially true as changing demographics and economic influences contribute to the burgeoning demand for affordable rental housing to which the market is not able to respond to on its own.[5]

While older, traditional responses to community housing needs still exist, the LIHTC program currently accounts for the majority of all new construction and preservation of affordable housing development nationally.[6] During the program's first 20 years, LIHTC units accounted for roughly one-third of all multifamily housing developments.[7] Recently, the program has supported 70,000 affordable rental units per year.[8] With such an extensive role in the housing development landscape, the LIHTC program is particularly of interest to American communities faced with widening income spreads and shrinking housing supply.[9]

This Comment explores and admonishes the various legal obstacles faced by affordable housing developers who participate in the LIHTC program and discusses recent updates to the program. In light of a severe housing shortage, lawmakers can and should make adjustments to the LIHTC program and related housing law to clear a path for housing developers. Specifically, increased allocation of credits and updates to the program are needed. A reduction in corporate tax rates introduced by the 2017 Tax Cuts and Jobs Act lowered the value of the tax credits in the market, which in turn is expected to reduce the number of affordable housing units that developers can build.[10] And while the neglected program received a modest increase in credit allocations in 2018, its first increase in over a decade, homeownership programs that contributed to the 2008 foreclosure crisis continue to drain billions from national treasuries.[11] Certain

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4. *See infra* Section II.B (describing the LIHTC program's significant effect on the real estate market, especially in terms of providing affordable housing).

5. *See infra* Section II.A (describing the growth in demand for rental housing).

6. JOINT CTR. FOR HOUS. STUDIES OF HARV. UNIV., THE STATE OF THE NATION'S HOUSING 2017, at 36 (2017), http://www.jchs.harvard.edu/sites/default/files/harvard_jchs_state_of_the_nations_housing_2017.pdf [http://perma.cc/3LWW-XZU8] [hereinafter STATE OF THE NATION'S HOUSING 2017].

7. OFFICE OF POLICY DEV. & RESEARCH, HUD, WHAT HAPPENS TO LOW-INCOME HOUSING TAX CREDIT PROPERTIES AT YEAR 15 AND BEYOND? 87 (2012), https://www.huduser.gov/publications/pdf/what_happens_lihtc_v2.pdf [http://perma.cc/PPF4-WLBN] [hereinafter LIHTC AT YEAR 15].

8. JOINT CTR. FOR HOUS. STUDIES OF HARVARD UNIV., AMERICA'S RENTAL HOUSING 2017, at 5 (2017) [hereinafter AMERICA'S RENTAL HOUSING 2017].

9. STATE OF THE NATION'S HOUSING 2017, *supra* note 6, at 32, 36.

10. *See infra* Section III.A (explaining the consequences stemming from the reduction of the corporate tax rate).

11. *See infra* Section II.A (explaining that failed federal homeownership policies contribute to the national deficit); Section III.B (describing the temporary increase in credit

programmatic characteristics of the LIHTC program need an update to allow developers to more accurately respond to modern housing needs and to promote more housing construction in targeted neighborhoods to achieve Congressional policy goals.[12]

Part II of this Comment describes persistent housing affordability challenges for American households and outlines the role of the LIHTC program in this context. Part III dives into the mechanics of the LIHTC program and highlights newly introduced obstacles from recent changes in the tax code. Part IV explores additional shortcomings of the LIHTC program and describes suggested reforms to increase developers' responsiveness to community housing needs. Finally, Part V focuses on the challenges that developers face in identifying appropriate locations to construct new affordable housing. Throughout the Comment, reference will be made to recent and proposed changes to the LIHTC program.

II. THE CURRENT AFFORDABLE HOUSING CRISIS AND THE ROLE OF THE LIHTC PROGRAM

A. *The Current Need for Affordable Housing*

The foreclosure crisis of 2008 evoked heightened awareness in the very "public nature of private housing" as the nation's market-based policies in the private housing market resulted in economic instability from the burst of the mortgage bubble.[13] Almost a decade after the historic disruption of the housing market, homeownership rates in the United States continue to fall annually while the number of renter households has grown steadily for the past twelve years.[14] Homeowners displaced by the foreclosure crisis are now renters.[15] Meanwhile, new potential home buyers, "Millennials,"[16] in

allocation in the 2018 omnibus bill).

12. *See infra* Part IV (explaining the various challenges the LIHTC program has caused); Part V (explaining the importance of location in the housing policy debate).

13. Ezra Rosser, *Laying the Foundation: The Private Rental Market and Affordable Housing*, 44 FORDHAM URB. L.J. 499, 502 (2017).

14. STATE OF THE NATION'S HOUSING 2017, *supra* note 6, at 19, 25. "The national homeownership rate dipped again for the 12th consecutive year" while "the number of renter households rose by 600,000 from 2015 to 2016, marking 12 consecutive years of growth . . . ." *Id.*

15. Jonathan Garber, *Here's How the US Housing Market Has Been Impacted by the 2008 Crash*, BUS. INSIDER (Feb. 11, 2016, 6:02 PM), http://www.businessinsider.com/impact-of-2008-crash-on-housing-2016-2 [http://perma.cc/Z8ZM-J5D8]. The housing markets with greater foreclosure rates experienced a greater shift from owning to renting. *Id.*

16. Americans born between 1985 and 2004 constitute the Millennial generation, which is more racially and ethnically diverse than previous American populations groups. STATE OF THE NATION'S HOUSING 2017, *supra* note 6, at 3, 14. This generation is the largest in recent history and will have a major impact on housing market trends in the next

particular, face increased obstacles to entering the housing market.[17] Impact from the foreclosure crisis is still felt across all demographics,[18] especially among individuals from "Generation X,"[19] many of whom became new homeowners in the years leading up to the burst and were more likely to "have the most debt and the least equity" in their homes before the crisis, placing them in a precarious financial position.[20] Federal housing policy that emphasized homeownership through market incentives is now understood to have been a major contributor to the housing burst that unseated many Americans' homeownership dreams.[21] This is the case even though the research cited by the government to warrant preferential treatment of homeowners has "not . . . adequately justif[ied]" this policy.[22] The federal tax code, as updated by the Tax Cuts & Jobs Act, still retains provisions from the failed federal homeownership policy that encourages buyers to purchase homes outside of their means[23] and

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decades. *Id.* at 13.

17. A. Mechele Dickerson, *Millennials, Affordable Housing, and the Future of Homeownership* 24 J. AFFORDABLE HOUSING & COMMUNITY DEV. L. 435, 442 (2016); JANET VIVEIROS ET AL., NAT'L HOUS. CONFERENCE & CTR. FOR HOUS. POLICY, PAYCHECK TO PAYCHECK: A SNAPSHOT OF HOUSING AFFORDABILITY FOR MILLENNIAL WORKERS 5 (2015), http://media.wix.com/ugd/19cfbe_e17dd74fd626472d8b2febba4caec37b.pdf [http://perma.cc/PE4M-4PN7].

18. STATE OF THE NATION'S HOUSING 2017, *supra* note 6, at 20.

19. Generation X, or Gen X, is the name given to Americans who were born between the Baby Boom generation and the Millennial generation, generally between 1965 and 1985. *See Generation X (Gen X)*, INVESTOPEDIA, https://www.investopedia.com/terms/g/generation-x-genx.asp [http://perma.cc/U5CC-K6QM] (last visited Nov. 2, 2018).

20. *Cf.* Shane Ferro, *Gen X Is the Most Screwed Generation When It Comes to Real Estate*, HUFFPOST (Mar. 30, 2016, 10:09 AM), https://www.huffingtonpost.com/entry/gen-x-screwed-real-estate-housing-crisis_us_56fad298e4b0143a9b497c9c [http://perma.cc/39FK-6N6J] (explaining that many Gen Xers were disproportionately affected by the Foreclosure Crisis); WEI LI & LAURI GOODMAN, URBAN INST., COMPARING CREDIT PROFILES OF AMERICAN RENTERS AND OWNERS 16 (2016), https://www.urban.org/sites/default/files/publication/78591/2000652-Comparing-Credit-Profiles-of-American-Renters-and-Owners.pdf [http://perma.cc/MR8Y-SPWC] (demonstrating that 7.1% of Gen Xers experienced a foreclosure).

21. Peter J. Wallison & Edward J. Pinto, *A Government-Mandated Housing Bubble*, FORBES (Feb. 16, 2009, 12:01 AM), https://www.forbes.com/2009/02/13/housing-bubble-subprime-opinions-contributors_0216_peter_wallison_edward_pinto.html#14861fdc778b [http://perma.cc/CXU6-2UEK].

22. Andrea J. Boyack, *Equitably Housing (Almost) Half a Nation of Renters*, 65 BUFF. L. REV. 109, 126 (2017).

23. Most notably, recent tax reform debate focused on a provision of the code that allows taxpayers to claim a deduction for interest on home mortgage debt. Conor Dougherty, *Tax Change on Mortgages Could Shake Up the Housing Market*, N.Y. TIMES (Nov. 2, 2017), https://www.nytimes.com/2017/11/02/business/economy/tax-housing.html [http://perma.cc/WU55-XL3A]. The mortgage interest deduction encourages the purchase of high-end market homes that are well outside of the median house price range and increases the percentage of home purchase that is financed by debt rather than down payments. *Id.*; James M. Poterba & Todd Sinai, *Revenue Costs and Incentive Effects of the*

contributes annually to the national deficit.[24]

Most government spending on housing goes toward subsidizing homeowners rather than renters. According to one estimate, 72% of the estimated $270 billion government spending on housing is allocated toward subsidizing homeowners.[25] Despite the government's preferential treatment for homeownership programs, the number of households headed by homeowners has remained relatively flat since 2006 even though the population of the United States has grown by 7.6 million.[26] The homeowner plateau is "in part because of the lingering effects of the housing crisis."[27] The stagnation in homeownership is accompanied by a large increase in renter households. According to the Pew Research Center, in July 2017 "more U.S. households [were] headed by renters than at any point since [the data was first tracked in] 1965."[28]

Although far less romanticized, renting provides a housing alternative to homeownership that may be economically healthier for some people, especially in markets where the cost of owning a home is overvalued.[29] Renters are able to scale their rental home costs to

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Mortgage Interest Deduction for Owner-Occupied Housing, 64 NAT'L TAX J. 541, 543 (2011); *see also* William G. Gale et al., *Encouraging Homeownership Through the Tax Code*, 115 TAX NOTES 1171, 1171 (2007) (noting that the mortgage interest deduction "serves mainly to raise the price of housing and land and to encourage people who do buy homes to borrow more and buy larger homes than they otherwise would"). Congress opted to keep the mortgage interest deduction in the code; although, it lowered the amount of acquisition indebtedness eligible for the deduction calculation from $500,000 to $375,000 in the case of married taxpayers filing separately. I.R.C. § 163(h)(3)(B)(ii) (2012 & Supp. III 2018).

24. The home mortgage interest deduction is projected to cost the U.S. government almost $896 billion in foregone tax revenue between 2017 and 2026. OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, ANALYTICAL PERSPECTIVES: BUDGET OF THE UNITED STATES GOVERNMENT, FISCAL YEAR 2018, at 127, 131 (2017).

25. Robert A. Collinson et al., *Low-Income Housing Policy* 1–2 (Kreisman Working Paper Series in Hous. Law & Policy, Working Paper No. 21071, 2015) (estimating that the government allocates roughly $195 billion toward homeownership programs); *see also* Andrea J. Boyack, *Sustainable Affordable Housing*, 50 ARIZ. ST. L.J. 455, 490 (2018) (explaining that "[e]very homeowner householder can deduct mortgage interest, every homeowner can defer capital gains when selling her primary residence, and every mortgage borrower benefits (directly or indirectly) from [Fannie Mae and Freddie Mac]'s role in making mortgage capital more broadly available" (internal citations omitted)).

26. Anthony Cilluffo et al., *More U.S. Households Are Renting Than at Any Point in 50 Years*, PEW RES. CTR. (July 19, 2017), http://www.pewresearch.org/fact-tank/2017/07/19/more-u-s-households-are-renting-than-at-any-point-in-50-years/[http://perma.cc/E55W-P48X].

27. *Id.*

28. *Id.*; *see also* Boyack, *supra* note 25, at 468 (commenting that the Pew Research Center's report of over 43.3 million households in July 2017 means "that there are more renters today than ever before, in both absolute and relative terms").

29. Neil Irwin, *Rent or Buy? The Math Is Changing*, N.Y. TIMES (May 21, 2014), https://www.nytimes.com/2014/05/22/upshot/rent-or-buy-the-math-is-changing.html [http://perma.cc/VFB9-CRXW].

fit their household needs, thereby enabling them to live more closely within their means and limiting their overall market exposure to fluctuations in housing prices.[30] Renting continues to increase among all age and income groups and across all household types.[31] While predicting future rental demand is difficult due to unexpected shifts in macroeconomic conditions, changing government policy, and many other variables, demand for rental housing is expected to grow, especially as a large segment of the Millennial generation moves into their 20s and 30s.[32]

Despite twelve consecutive years of growth in demand for rental housing,[33] the marketplace and government policies have failed to respond. In the marketplace, "[b]etween 2005 and the end of 2014, only 2.2 million new units intended as rentals were completed—the lowest 10-year production rate on record since 1974."[34] Forces of supply and demand are still at work as developers respond to increased demand for rentals.[35] But because affordable units are as expensive to build as luxury units, most new construction of rental housing caters to high-income renters.[36] Ultimately, the high cost to produce rental housing means that the private market has no incentive to develop housing that is affordable for low-income families.[37] Also, of note, new multifamily developments are being constructed with fewer bedrooms—which may result in a higher price per bedroom—making these housing facilities more unaffordable for families

30. Dickerson, *supra* note 17, at 461–63; Irwin, *supra* note 29.

31. AMERICA'S RENTAL HOUSING 2017, *supra* note 8, at 7–8.

32. *Id.* at 11–12.

33. STATE OF THE NATION'S HOUSING 2017, *supra* note 6, at 25. *But see id.* ("[T]he level of rental growth in 2016 did represent a sharp deceleration from the previous two years.").

34. OFFICE OF U.S. SEN. MARIA CANTWELL, MEETING THE CHALLENGES OF THE GROWING AFFORDABLE HOUSING CRISIS: EXPANDING AND IMPROVING THE HOUSING TAX CREDIT 2 (2017), https://www.cantwell.senate.gov/imo/media/doc/03062017_Meeting%20the%20challenge%20of%20the%20growing%20affordable%20housing%20crisis%20REPORT.pdf [http://perma.cc/QG5K-3GLG] [hereinafter CANTWELL].

35. *See* STATE OF THE NATION'S HOUSING 2017, *supra* note 6, at 27 ("[C]onstruction of multifamily housing has been increasing since 2010 . . . .").

36. Boyack, *supra* note 22, at 118; *see also* STATE OF THE NATION'S HOUSING 2017, *supra* note 6, at 27 ("Recent additions to the rental supply remain concentrated at the upper end of the market. . . . The 2015 American Community Survey data for the 100 largest metros . . . indicat[es] that nearly half (46 percent) of the rental units built in 2010 or later were in the top quartile of area rents, while more than two-thirds fell into the top half.").

37. *See* Rosser, *supra* note 13, at 523. At this point, constructing affordable housing is "fundamentally uneconomic." AFFORDABLE RENTAL HOUS. A.C.T.I.O.N., BUILDING AFFORDABLE HOUSING COMMUNITIES USING THE LOW-INCOME HOUSING TAX CREDIT 6 (2015), http://www.taxcreditcoalition.org/wp-content/uploads/2015/03/Housing-Credit-Ed-Deck-March-2015-ver-14-3.pdf [http://perma.cc/59VA-CW4X] (last visited Nov. 2, 2018) [hereinafter BUILDING AFFORDABLE HOUSING].

classified as very low-income.[38]

Traditional government programs designed to address the affordable housing shortage, such as housing vouchers or public housing programs, "fall[ ] short of need."[39] The U.S. Department of Housing and Urban Development ("HUD") reported in 2017 that only 24.9% of very low-income families qualified to receive housing assistance actually receive assistance, leaving three-quarters of low-income households to navigate scarce supply and high demand in the marketplace without any traditional government assistance.[40] Although Congress has recently increased funding for some of these programs, namely the Housing Choice Voucher program, rising costs for rental units limit the number of families served.[41] Adding to the shortage, over a million affordable rental units, which are subsidized or rent-restricted through government programs, are set to expire out of the market or revert to private market rates in the next ten years.[42]

Even with multifamily construction at higher levels in 2015 and 2016,[43] the demand for rental housing continues to outpace supply in most metro areas, which drives prices for rental rates up.[44] Due to the constrained supply of rental units, rental rate increases average out to the highest rate in thirty years.[45] Meanwhile, renter incomes remain stagnant.[46] As a consequence of increased rental rates and stagnating wages, "[i]n no state, metropolitan area, or county can a worker earning the federal minimum wage or prevailing state minimum wage afford a two-bedroom rental home at fair market rent by

38. STATE OF THE NATION'S HOUSING 2017, *supra* note 6, at 27–28.

39. *Id.* at 35.

40. NICOLE ELSASSER WATSON ET AL., OFFICE OF POLICY DEV. & RESEARCH, HUD, WORST CASE HOUSING NEEDS: 2017 REPORT TO CONGRESS 10 (2017), https://www.huduser.gov/portal/sites/default/files/pdf/Worst-Case-Housing-Needs.pdf [http://perma.cc/THQ4-E26E]. Very low-income is defined as a household with income of less than 50% of the area median. *Id.* at ix.

41. AMERICA'S RENTAL HOUSING 2017, *supra* note 6, at 5 (noting that "[d]espite a 6.8 percent increase in funding between 2011 and 2016, rising rents kept growth in the number of voucher [recipients] to just 5.8 percent").

42. *See infra* note 72 and accompanying text.

43. STATE OF THE NATION'S HOUSING 2017, *supra* note 6, at 27.

44. *Id.* at 25; Boyack, *supra* note 22, at 117–18.

45. CANTWELL, *supra* note 34, at 2; *see also* Boyack, *supra* note 22, at 125, 133.

46. STATE OF THE NATION'S HOUSING 2017, *supra* note 6, at 16. To be more precise, "the median household income for renters in the bottom quintile fell 9.9 percent between 2001 and 2014, while their median monthly housing costs rose 6.2 percent." AMERICA'S RENTAL HOUSING 2017, *supra* note 8, at 26. Even higher-income renters see wide divergence in rental rates and incomes. "[T]he median income for households in the top quintile was up 3.1 percent, but their median monthly housing costs jumped 19.8 percent over this period." *Id.*; *see also* Boyack, *supra* note 22, at 118–19. (discussing the trend towards luxury rental units and its negative effects on lower-income renters).

working a standard 40-hour week."[47] HUD regards housing expenses to be "affordable" if a household can rent a unit without paying more than 30 percent of its income toward utilities and rent.[48] Following the foreclosure crisis, record rates of renters experienced housing cost burdens well above 30 percent of their income.[49] Although the number of cost-burdened households has dropped in the years following the crisis, "fully one-third of all US households paid more than 30 percent of their incomes on housing in 2015."[50] Renters, as compared to homeowners, are especially cost-burdened. In 2015, 48 percent of renter households were cost burdened, with 26 percent of renter households paying over half of their income on rent.[51]

Because burgeoning demand for rental units has not been met, higher income households occupy almost half of the units on the private market that would be affordable to low-income families.[52] As of 2014, for every 100 extremely low-income households, only 46 adequate and "affordable" rental units were actually available.[53] The market currently provides approximately 21 of the units, and federal assistance provides approximately 24.[54]

B. The LIHTC program and Its Impact

The Low-Income Housing Tax Credit ("LIHTC") program[55] deserves special attention because it is the only program that seeks to

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47. NAT'L LOW INCOME HOUS. COAL., OUT OF REACH 2018, at 1 (2018).

48. *Glossary of HUD Terms*, OFFICE OF POL'Y DEV. & RESEARCH, HUD, https://www.huduser.gov/portal/glossary/glossary_a.html [perma.cc/3B2S-5LWH] (last visited Nov. 2, 2018).

49. Lance Bocarsly & Rachel Rosner, *The Low Income Housing Tax Credit: A Valuable Tool for Financing the Development of Affordable Housing*, PRAC. REAL EST. LAW, Jan. 2017, at 29, 31. Cost burdened is defined as a household that pays more than 30% of its income on rent. STATE OF THE NATION'S HOUSING 2017, *supra* note 6, at 33.

50. STATE OF THE NATION'S HOUSING 2017, *supra* note 6, at 31.

51. *Id.*

52. ANDREW AURAND ET AL., NAT'L LOW INCOME HOUS. COAL., THE GAP: A SHORTAGE OF AFFORDABLE HOMES 4 (2017), http://nlihc.org/sites/default/files/Gap-Report_2017.pdf [http://perma.cc/M69Y-YYYK].

53. LIZA GETSINGER ET AL., URBAN INST., THE HOUSING AFFORDABILITY GAP FOR EXTREMELY LOW-INCOME RENTERS IN 2014 4 (2017), https://www.urban.org/research/publication/housing-affordability-gap-extremely-low-income-renters-2014 [http://perma.cc/3E96-TMV6]; For an interactive map of affordable housing on a county-wide level, see Urban Inst., *Mapping America's Rental Housing Crisis*, URBAN.ORG (Apr. 27, 2017), http://apps.urban.org/features/rental-housing-crisis-map/ [http://perma.cc/7RSH-TMEA]. The Joint Center for Housing Studies of Harvard University reported slightly different numbers: "Nationwide, there were only 35 affordable and available units for every 100 extremely low-income households and 55 units for every 100 very low-income households." STATE OF THE NATION'S HOUSING 2017, *supra* note 6, at 35.

54. GETSINGER ET AL., *supra* note 53.

55. I.R.C. § 42 (2012).

respond to low-income renter household demand by incentivizing the production of affordable housing in the private market.[56] The program provides a market-based solution by incentivizing investment in privately developed multifamily dwellings.[57] In response to the issue of affordable housing—which, at its core, is an economic issue—the LIHTC program provides an economic solution that seeks to stimulate markets with tax incentives.[58]

The LIHTC program was first created under the Tax Reform Act of 1986, signed into law by President Ronald Reagan,[59] and became a permanent program under the Omnibus Budget Reconciliation Act of 1993.[60] Congress deliberately retained the program in the tax code during the major tax reform undertaken in 2017 and acknowledged the LIHTC program as a core part of the code's "business tax system."[61] As a market-based solution to address the housing needs of low-income Americans, the program is designed to incentivize investment of private equity into the development of affordable rental housing by providing a matching framework for investment in certain low-income housing developments.[62] Improvements and updates to the program were implemented under the Consolidated Appropriations Act, 2018 (the "2018 Omnibus Bill").[63]

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56. *See* Alan Mallach, *The Elusive Goal of a Decent Home and a Suitable Living Environment: Confronting Today's Housing Challenges*, 51 U.S.F. L. REV. 75, 96 (2017).

57. Bocarsly & Rosner, *supra* note 49, at 30.

58. *Cf.* Mallach, *supra* note 56, at 91–92 (noting that economic initiatives that influence the market economy are necessary to affect change in the housing arena).

59. Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085 (codified as amended at 26 U.S.C. § 42 (2012)).

60. Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, § 13142, 107 Stat. 312, 438.

61. In the Senate Finance Committee policy summary released during negotiations before the bill passage, the LIHTC was noted as one of the "important elements of the existing business tax system" because it encouraged businesses to invest in affordable housing. *See* U.S. SEN. COMM. ON FIN., 115TH CONG., TAX CUTS & JOBS ACT POLICY HIGHLIGHTS 2 (Comm. Print 2017), https://www.finance.senate.gov/imo/media/doc/11.9.17%20Policy%20Highlights.pdf [http://perma.cc/QP6N-C4VW]. Similarly, a House Ways and Means Committee policy document regarding the Tax Cuts and Jobs Act specifically retained the LIHTC provision because the program incentivizes business investment and economic development. *See* U.S. HOUSE WAYS & MEANS COMM., 115TH CONG., THE TAX CUTS & JOBS ACT COMMUNICATIONS AND POLICY DETAILS 23–24 (2017), https://waysandmeans.house.gov/wp-content/uploads/2017/10/WM_TCJA_PolicyOnePagers.pdf [http://perma.cc/3HU2-AK2H]. A Senate-proposed amendment to reduce a basis boost provision (the 30% "basis boost") aimed at supporting housing development in "difficult development area[s]" was not adopted by the conference committee. H.R. REP. NO. 115-466, at 540–42 (2017) (Conf. Rep.).

62. *See* OFFICE OF THE COMPTROLLER OF THE CURRENCY, LOW-INCOME HOUSING TAX CREDITS: AFFORDABLE HOUSING INVESTMENT OPPORTUNITIES FOR BANKS 1–2 (2014), https://occ.gov/topics/community-affairs/publications/insights/insights-low-income-housing-tax-credits.pdf [http://perma.cc/34Y5-ZRX7] [hereinafter OCC LIHTC FOR BANKS].

63. *See* Consolidated Appropriations Act, 2018, Pub. L. No. 115-141, § 103, 132 Stat.

Tax credit programs differ from government subsidized rental assistance programs by focusing on different sides of the "supply and demand" of markets. "Demand-side" government assistance programs like Section 8 and Housing Choice Vouchers seek to "fund the shortfall" between low incomes and the high cost to develop housing by subsidizing the rents of tenants.[64] These programs serve those living in over 5 million housing units (mostly families with children, older adults, and people with disabilities who are not in the workforce),[65] but they have come under scrutiny for their excessive cost per unit and negative effects of pushing up inner-city rents and concentrating low-income and minority tenants in low opportunity neighborhoods.[66] In contrast, the LIHTC program is a "supply-side" program that exerts downward pressure on rental prices by growing the affordable housing stock.[67] The LIHTC program also faces scrutiny,[68] including emerging evidence that the credit is attached to development expenditures instead of affordability of units, the program may increase development costs and would therefore be more expensive per unit than direct subsidies to tenants in the form of vouchers.[69] Despite some of the inherent issues in both programs, the LIHTC program receives ongoing bipartisan support[70] and currently serves as the primary federal program aimed at producing new rental units for low-income households.[71] Rental properties under both

348, 1157; *see also infra* Part III.B.

64. Boyack, *supra* note 22, at 133–34.

65. STATE OF THE NATION'S HOUSING 2017, *supra* note 6, at 35–36.

66. Mallach, *supra* note 56, at 93–94.

67. Boyack, *supra* note 22, at 134–35.

68. For example, assertions that the LIHTC program reinforces economic and racial segregation culminated in a Supreme Court case *Dep't of Hous. & Cmty. Affairs v. Inclusive Cmtys. Project, Inc.* 135 S. Ct. 2507 (2015) and new regulations developed by HUD in response. *See infra* Part V. Also, because LIHTC property rental rates are set at median area rate, critics note that the units are often not accessible to the lowest income families. *See infra* Section III.B. Finally, diminished oversight complicates congressional understanding of the program. *See infra* Section IV.B.

69. GETSINGER ET AL., *supra* note 53, at 4 (stating that fewer units were naturally affordable in 2014 than 2000); Lan Deng, *The Cost-Effectiveness of the Low-Income Housing Tax Credit Relative to Vouchers: Evidence from Six Metropolitan Areas*, 16 J. HOUSING POL'Y DEBATE 469, 505 (2005). For an in-depth account of how the program structure may provide incorrect incentives for developers, see *In America's Affordable Housing Crisis, More Demand but Less Supply* (Frontline broadcast May 9, 2017), https://www.pbs.org/wgbh/frontline/article/in-americas-affordable-housing-crisis-more-demand-but-less-supply/ [http://perma.cc/LVX9-5H8D] [hereinafter *America's Affordable Housing Crisis*].

70. The 2017 Tax Cuts and Jobs Act preserved the LIHTC program in its entirety despite numerous efforts to cut other tax credits. *See* H.R. REP. NO. 115-466, at 541–42 (2017) (Conf. Rep.) (rejecting amendments to the LIHTC program).

71. AMERICA'S RENTAL HOUSING 2017, *supra* note 8, at 5; MARK P. KEIGHTLEY, CONG. RESEARCH SERV., RS22389, AN INTRODUCTION TO THE LOW-INCOME HOUSING TAX CREDIT

types of programs are designed to provide affordable housing for only temporary amounts of time. Over the next ten years, contracts for over 650,000 subsidized rentals and affordability requirements for nearly 500,000 LIHTC units are set to expire.[72]

The LIHTC program has a major impact across the country. For affordable rental developments, the tax credits ("LIHTCs") are the key financing source in "almost every affordable rental project"[73] and are regarded as "the primary source of support for new affordable rental units."[74] Remarkably, almost one-third of all newly constructed multifamily housing units used LIHTCs as a source of funding between 1987 and 2006.[75] As of 2016, the LIHTC program had contributed to the creation of approximately 3.05 million affordable housing units[76] and, in recent years, has supported the construction of approximately 70,000 affordable units per year.[77] The credits are in high demand: state agencies responsible for distributing LIHTCs to developers receive far more applications for credits than the number of available allocations annually.[78] Still, as noted above, even with the market incentives embedded into the tax code through the LIHTC program, the housing marketplace has not responded to the high demand for affordable housing.[79]

III. MECHANICS OF THE LIHTC PROGRAM AND NEWLY INTRODUCED OBSTACLES

The LIHTC program is notoriously complex. This portion of the Comment describes how the program works in simplified terms so that the challenges faced by developers are highlighted.

Every year the federal government spends approximately $9 billion on the LIHTC program which provides tax credits to state

1 (2018).

72. AMERICA'S RENTAL HOUSING 2017, *supra* note 8, at 5. Although the expiration of millions of affordable units has significant implications for affordable housing supply, a HUD commissioned report found that most LIHTC properties retained rental rates like those required by the LIHTC program rental restriction provisions immediately after the 15-year period of mandated compliance, a testament to the long-term benefits of the LIHTC program. LIHTC AT YEAR 15, *supra* note 7, at 50.

73. Boyack, *supra* note 22, at 137.

74. AMERICA'S RENTAL HOUSING 2017, *supra* note 8, at 32.

75. LIHTC AT YEAR 15, *supra* note 7, at 3.

76. *Dataset/Low-Income Housing Tax Credits*, OFFICE OF POLICY DEV. & RESEARCH, HUD, https://www.huduser.gov/portal/datasets/lihtc.html [http://perma.cc/M6MV-ZTS5] (last revised June 6, 2018).

77. AMERICA'S RENTAL HOUSING 2017, *supra* note 8, at 5.

78. *See infra* note 158 and accompanying text.

79. *See* STATE OF THE NATION'S HOUSING 2017, *supra* note 6, at 35.

housing agencies based on state population.[80] The state agencies then distribute credits to selected housing project developers.[81] In exchange for LIHTCs, the developer must agree to use the credits for new construction or rehabilitation of low-income rentals and comply with specific rental rate restrictions for up to 30 years.[82] Developers typically sell the credits to investors to obtain cash for construction.[83] The lowered financing costs theoretically allow the properties to offer more affordable rents because while most real estate is financed with debt in the range of 60% to 90% of value, LIHTC properties are funded primarily with equity from investors and are generally financed with hard debt in the range of 10% to 30% of the project's value.[84] Investors who purchase LIHTCs obtain equity in the project, can use the credits to directly offset liability on their tax returns for a 10-year period, and can recognize taxable losses from the project for 15 years.[85] An entire industry has been built around the complex program to bring together developers with investors who pay less in taxes for every tax credit that they purchase as an investment to build low-income housing.[86]

Types of Credits

Two primary types of credits are available under the program.[87]

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80. MARK P. KEIGHTLEY, *supra* note 71, at 1–2 (2017). To be more precise, the 9% credits are distributed based on construction costs, and the 4% credits are allocated based on bond financed projects. *Id.* at 1. States received an allocation of $2.35 per person in 2017 with small states receiving the minimum allocation of $2,710,000. *Id.* at 2. The 2018 omnibus bill provided a temporary four-year increase in the credit allocation. *See infra* Part III.B.

81. *See* I.R.C. § 42(h)(1)(F) (2012).

82. I.R.C. § 42(i)(1) defines an initial "compliance period" of 15 years during which the LIHTC project must comply with rent restriction requirements. A 1990 addition to the Code requires new LIHTC properties to preserve affordable rent restrictions for 30 years with the addition of an "extended use period" where the project must make a long-term commitment with a state agency. I.R.C. § 42(h)(6)(B)(i); I.R.C. § 42(h)(6)(D). For a more detailed discussion of the extended compliance periods see *Affordable Housing Resource Center*, NOVOGRADAC & CO. LLP, https://www.novoco.com/resource-centers/affordable-housing-tax-credits/lihtc-basics/about-lihtc [http://perma.cc/9RLS-MKJA] (last visited Nov. 2, 2018).

83. KEIGHTLEY, *supra* note 71, at 2.

84. BUILDING AFFORDABLE HOUSING, *supra* note 37, at 8.

85. Bocarsly & Rosner, *supra* note 49, at 32. Credits, as opposed to deductions, are much more valuable tax-reduction tool to investors. Desiree C. Hensley, *Out in the Cold: The Failure of Tenant Enforcement of the Low-Income Housing Tax Credit*, 82 U. CIN. L. REV. 1079, 1089 (2014).

86. *Cf. About*, NASLEF, https://naslef.org/about/ [http://perma.cc/2PMK-9B93] (last visited Nov. 2, 2018) (a nonprofit organization that has raised $14.5 billion to promote the development of affordable rental housing).

87. A third type of "enhanced" credits (known as "basis boost" credits) is also available to incentivize investment in more distressed areas. KEIGHTLEY, *supra* note 71, at 3. These

A "4 percent credit" is available for housing projects that use tax-exempt bonds and generally provides a 30% subsidy for projects.[88] When Congress recently debated the removal of tax-exempt status for private activity bonds like the ones paired with the 4 percent credit, industry experts advised that this move would disable "the use of the 4% low-income housing tax credit, which is linked to tax-exempt financing and represents approximately 45% of the low-income housing tax credit program."[89] After bipartisan support emerged for maintaining tax-exempt status for such bonds,[90] the conference committee retained tax-exempt treatment of these bonds in the 2017 revised code.[91] Because municipal bonds have a lower interest rate and come paired with tax credits they are especially useful for funding high-cost developments such as senior housing.[92] Further, 4 percent credits are also often used to support rehabilitation of existing buildings.[93] The second type of credit, referred to as the "9 percent credit," can be used for projects that do not use tax-exempt bonds; this credit provides a 70% subsidy for projects and is generally used to fund new construction.[94]

With either credit, the federal government essentially covers a portion of the cost to construct affordable housing development by allowing investors to reduce their income taxes up to the present value of the project.[95] To illustrate, consider a developer seeking

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credits are mostly beyond the scope of this Comment but will be discussed further in Part V.

88. Bocarsly & Rosner, *supra* note 49, at 32.

89. Letter from the Nat'l Ass'n of Bond Lawyers, to Majority Leader McConnell, Speaker Ryan, and Minority Leaders Schumer and Pelosi (Nov. 9, 2017), https://www.taxnotes.com/tax-notes-today/tax-exempt-bonds/bond-lawyers-group-urges-retention-current-bonds-treatment/2017/11/10/1x9v4 [http://perma.cc/Y8J3-5TNH]. The ABA also advocated for retaining tax-exempt status for "certain types of bond issues that have a recognized public purpose under state law" and emphasized a long government history of using bonds to achieve social goals. Letter from the ABA Section of Taxation, to John A. Koskinen, Comm'r, IRS (May 10, 2017), https://www.americanbar.org/content/dam/aba/administrative/taxation/policy/051017comments.authcheckdam.pdf [http://perma.cc/QYP6-J9QE].

90. Letter from 35 Cmty. Orgs. to Majority Leader McConnell, Speaker Ryan, and Minority Leaders Schumer and Pelosi (Dec. 6, 2017), https://www.taxnotes.com/tax-notes-today/tax-preference-items-and-incentives/groups-call-preservation-private-activity-bonds/2017/12/08/1xdcw?highlight=affordable%20housing [http://perma.cc/NR2K-BFUB].

91. H.R. REP. NO. 115-466, at 457–58 (2017) (Conf. Rep.). However, Congress did change the calculation for annual inflation adjustments throughout the tax code which is expected to decrease future allocation of both LIHTCs and private activity bonds. *See infra* Section III.A.

92. Boyack, *supra* note 22, at 143.

93. *Affordable Housing Resource Center*, *supra* note 82.

94. *Id.*; Bocarsly & Rosner, *supra* note 49, at 32.

95. *See* KEIGHTLEY, *supra* note 71, at 1 & n.2 (discussing the concept of present value).

funding for a $10 million housing project that is awarded a 9 percent credit allocation from the state. The developer can use the 9 percent credit to attract investors who buy the credits by investing equity into the project. In exchange for equity investment, the investor receives tax credits for 9% of the $10 million value of the project for ten years ($900,000 a year for 10 years, totaling $9 million).[96] The amount of money that an investor is willing to contribute to a property in exchange for the credits fluctuates based on how valuable the future credits are based on a present-value analysis.[97] This means that the 9 percent credit in this illustration will be worth about $7 million to the investor today. The investor payment of $7 million in exchange for $9 million of credit allocations over 10 years becomes an equity investment covering 70% of construction costs. In 2015, Congress passed the Protecting Americans from Tax Hikes Act, which permanently preserved a credit rate formula for the program to ensure that the 9 percent credits would achieve a minimum of 70% subsidies regardless of current market-rate interest rates that fluctuate over time.[98]

Many LIHTC projects use the 9 percent credit, which is reserved for new construction and requires a competitive bidding process through the state administrator.[99] Each state distributes credits to developers in accordance with a Qualified Allocation Plan ("QAP"),[100] which sets eligibility criteria for projects to respond to local conditions. Beyond a congressional command to prioritize disbursements to projects that "serve the lowest income households and that remain affordable for the longest period of time,"[101] state housing agencies have wide latitude to set criteria in the development of each state QAP and wield control (or not) over various allocation considerations.[102] Developers seeking to use LIHTCs are charged with

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96. OCC LIHTC FOR BANKS, *supra* note 62, at 12.

97. KEIGHTLEY, *supra* note 71, at 1.

98. *See* Protecting Americans from Tax Hikes Act of 2015, Pub. L. No. 114-113, § 131, 129 Stat. 3040, 3055; STAFF OF THE JOINT COMM. ON TAXATION, 114TH CONG., TECHNICAL EXPLANATION OF THE PROTECTING AMERICANS FROM TAX HIKES ACT OF 2015, HOUSE AMENDMENT #2 TO THE SENATE AMENDMENT TO H.R. 2029 46–47 (Comm. Print 2015).

99. KEIGHTLEY, *supra* note 71, at 2–4.

100. *See* I.R.C. § 42(m)(1)(B) (2012).

101. KEIGHTLEY, *supra* note 71, at 2; I.R.C. § 42(m)(1)(B).

102. *See* David B. Wilderman, *Market Study Standards*, NOVOGRADAC & CO. LLC (2011), https://www.novoco.com/sites/default/files/atoms/files/market_study_standards_alignment_072711.pdf [http://perma.cc/4PT7-MYJQ] ("Among states, practice varies widely, with some States prescribing sound but unique methodologies, while others have only loosely defined standards . . . ."). The statute does provide a basic list of ten factors that states must incorporate into project selection criteria but provides no direction regarding how they should be incorporated into the selection criteria. I.R.C. § 42(m)(1)(C). The statute also mandates that states allocate at least 10% of the tax credits to projects involving

navigating the application for their state by proposing development projects that comply with individual state QAP guidelines and score better than other applicants to successfully compete for the credits.[103]

Because each state's QAP serves as one of the initial thresholds for developers seeking to obtain the valuable investment credits, state QAPs have come under occasional judicial scrutiny. For example, in a recent United States Supreme Court case, *Department of Housing & Community Affairs v. Inclusive Communities Project, Inc.*, a nonprofit housing agency that helps low-income families obtain affordable housing, challenged the Texas QAP as inequitable under a disparate impact theory.[104] Bid protests and other claims challenging agency procedure may also seek judicial review.[105]

<u>Investors</u>

Most LIHTCs are used on corporate income tax returns as a tax break to offset taxable income.[106] Investors often realize additional tax benefits by structuring financing arrangements with partnership transactions. In a typical LIHTC deal, the project developer enters into a project entity agreement (usually a limited partnership agreement or a limited liability operating agreement) with an investor who contributes 99.99% equity in exchange for 99.99% of the credits, while the developer handles the project development and management.[107] Under the typical partnership arrangement described above, investors can also claim 99.99% of the depreciation and interest expense deductions from the project over the life of the investment.[108] State ad valorem tax-exemption policies allow nonprofit owner/developer agencies, who may have only retained 0.01% interest in legal title, extend tax-exempt status to the property itself to shield the investment from property taxes.[109] Investors may also benefit from other tax credit programs, which may be paired with LIHTCs for certain projects.[110] Banks, the primary investors in

nonprofit developers. I.R.C. § 42(h)(5).

103. *See* I.R.C. § 42(m).

104. Dep't of Hous. & Cmty. Affairs v. Inclusive Cmtys. Project, Inc., 135 S. Ct. 2507, 2512 (2015).

105. *Cf., e.g.*, Darby v. Cisneros, 509 U.S. 137, 154 (1993) (discussing judicial review and the exhaustion of administrative remedies requirement).

106. KEIGHTLEY, *supra* note 71, at 4.

107. Bocarsly & Rosner, *supra* note 49, at 32.

108. *Id.*

109. *Cf. In re* Blue Ridge Hous. of Bakersville LLC, 738 S.E..2d 802, 805–06, 814 (N.C. Ct. App 2013) (holding extension of tax-exempt status is consistent with the Fourteenth Amendment of the Constitution because the tax exemption is applied uniformly), *aff'd* 753 S.E.2d 152 (N.C. 2014) (per curiam).

110. OCC LIHTC FOR BANKS, *supra* note 62, at 6–9.

LIHTCs for affordable housing development, are drawn to the program because returns on investments in LIHTC projects "have been competitive with similar alternative investment opportunities," because foreclosures are "relatively rare," and because participation in LIHTC projects provides additional lending opportunities and the ability to leverage other credit investments.[111] Banks are also motivated to invest by the Community Reinvestment Act, which favorably considers LIHTC investments in evaluating banks for compliance with the act's mandate for banks to serve community needs.[112]

Recent changes from both the Tax Cuts and Jobs Act and the 2018 Omnibus Bill are expected to impact the quantity of affordable housing units that developers can build under the program and logistics of program administration. While the complex and nuanced tax credit program is worthy of an extensive and specialized review in response to the newest legal reforms, this Comment provides only a broad policy overview and expected impacts to illustraet developer obstacles.

A. *Programmatic Impact from the Tax Cuts and Jobs Act of 2017.*

The LIHTC program was retained in its entirety in the 2017 Tax Cuts and Jobs Act, including the 30% basis boost provided for areas that face particular development challenges.[113] Congress also retained the federal income tax exemption for private activity bonds, which are paired with 4 percent credits; although, a minor change to the calculation for annual inflation adjustments is expected to decrease the annual volume of LIHTC and private activity bond allocations.[114] The change-in-inflation-factor calculations are expected to lead to a loss of at least 18,700 to 19,900 affordable rental homes developed over the next 10 years.[115]

While the 2017 Tax Cuts and Jobs Act did not directly modify the LIHTC program, several of the bill's provisions will impact LIHTC investments. Most significantly, reduction of the corporate tax rate from 35 percent to 21 percent is expected to lower the value of the tax credits resulting in a drop in affordable housing

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111. *Id.* at 6–8.

112. *Id.* at 7.

113. *See* H.R. REP. NO. 115-466, at 541–42 (2017) (Conf. Rep.).

114. *Id.* at 457–58; Michael Novogradac, *Final Tax Reform Bill Would Reduce Affordable Rental Housing Production by Nearly 235,000 Homes* NOVOGRADAC & CO. LLC (Dec. 19, 2017, 12:00 AM), https://www.novoco.com/notes-from-novogradac/final-tax-reform-bill-would-reduce-affordable-rental-housing-production-nearly-235000-homes [http://perma.cc/A6Z5-R3AP].

115. Novogradac, *supra* note 114.

production.[116] When corporate investors have lower tax bills the tax-reduction benefits of LIHTC projects are less attractive, meaning that instead of paying dollar-for-dollar for each credit, investors are only willing to pay 90 cents or less for each dollar of credit.[117] Further, the lowered corporate tax rate change reduces the value of tax losses that investors can claim from the project to offset taxable income.[118] The Trump administration's pledge to lower corporate taxes had investors curtailing the amount of money that they were willing to commit to affordable housing projects and lowering the value of the credit a full year before Congress enacted tax reform.[119] In fact, the value of the tax credits had already dropped 16 cents under the Trump administration in advance of the 2017 tax reform as investors anticipated tax cuts.[120] The value of LIHTCs is expected to drop three or four cents lower as the new bill provisions are rolled out.[121] When fewer dollars are raised by the developers who sell the credits, affordable housing projects face large funding gaps and must look for financing from other housing assistance entities who also anticipate imminent funding cuts.[122] The reduction of capital from the private sector flowing into the LIHTC program is expected to lead to a loss of at least 200,500 to 212,400 affordable rental homes developed over the next 10 years.[123]

Other changes to the Internal Revenue Code under the Tax Cut

116. *Id.*

117. Katheleen Conti, *Low-Income Housing Financing Takes Hit from Trump's Tax-cut Promise*, BOS. GLOBE (Mar. 12, 2017), https://www.bostonglobe.com/business/2017/03/12/low-income-housing-financing-takes-hit-from-trump-tax-cut-promise/VmBBSx9Eyrehwx1fLfKgTP/story.html [http://perma.cc/P5TW-X8DW]. Another way of understanding the lowered value of credits is that the investor equity price per credit necessary to achieve the same yield in tax benefits decreases. Dirk Wallace & Michael Novogradac, *Tax Reform Could Significantly Affect LIHTC Equity Market*, NOVOGRADAC & CO. LLC (Dec. 29, 2016, 12:00 AM), https://www.novoco.com/notes-from-novogradac/tax-reform-could-significantly-affect-lihtc-equity-market [http://perma.cc/ZTC3-RUF4].

118. Dirk Wallace et al., *How Congress Could Offset the Effects on Affordable Housing Projection of a Reduced Corporate Rate*, NOVOGRADAC & CO. LLC (Apr. 17, 2017, 12:00 AM), https://www.novoco.com/notes-from-novogradac/how-congress-could-offset-effects-affordable-housing-production-reduced-corporate-rate [http://perma.cc/PJ3M-GFJK] (explaining how a reduction in tax rates lowers the value of offsetting deductions).

119. Conti, *supra* note 117.

120. Rebecca Elliott, *Tax Reform Adds Uncertainty to Houston's Weak Affordable Housing Supply*, HOUS. CHRON. (Dec. 26, 2017, 7:08 PM), https://www.houstonchronicle.com/news/houston-texas/houston/article/Tax-reform-adds-uncertainty-to-Houston-s-weak-12456296.php [http://perma.cc/5BA9-29TA].

121. Conti, *supra* note 117; Elliott, *supra* note 120.

122. Conti, *supra* note 117; Elliott, *supra* note 120.

123. Novogradac, *supra* note 114. The reduction in affordable housing development is expected to eliminate more than 262,000 jobs and potential state and local tax revenue associated with the LIHTC program because of the lost value in credits. *Id.*

and Jobs Act are expected to impact LIHTC investments to varying degrees. For example, corporate taxpayers subject to the new Base Erosion and Anti-Abuse Tax ("BEAT tax") may find that LIHTC investments are less desirable. The new tax applies retroactively to certain taxpayers, many of whom are investors in projects that rely on tax credits.[124] The complicated BEAT computations limit the offsetting tax reduction benefits of the LIHTC program and many of the accompanying tax credit programs for certain investors.[125] Additionally, the limitation of the net interest expense deduction to 30% of adjusted income through 2021 and 30% of earnings before interest in taxes could reduce tax benefits for investors.[126] However, because real property trade or business can elect out of the interest expense deduction limitation if the property is depreciated over 30 years, the new law could either modify depreciation schedules for LIHTC properties or could change projected yield, depending on how the property is leveraged.[127] Finally, the Tax Cuts and Jobs Act provides full and immediate depreciation for personal property and site improvements placed into service after September 27, 2017 with a phase-out between 2023 and 2027.[128] Immediate deduction for site improvements increases the present value of an LIHTC investment because investors can enjoy greater immediate tax benefit even though the total amount of deductions generated by the investment remains the same.

Although Congress neglected to increase much-needed credit allocations for the LIHTC program, the 2017 Tax Cuts and Jobs Act did include a limitless tax giveaway under the new Opportunity Zones program.[129] The program seeks to stimulate investment in certain low-income neighborhoods but imposes no affordability requirements or restrictions to curb potential gentrification issues that could expel local residents.[130] The Opportunity Zones program allows

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124. H.R. Rep. No. 115-466, at 649–64 (2017) (Conf. Rep.); Forrest D. Milder, *Introduction to the BEAT (Base Erosion Anti-Abuse Tax) for Investors in Tax Credit Projects*, NIXON PEABODY TAX CREDIT ALERT (Mar. 20, 2018), https://www.nixonpeabody.com/-/media/Files/Alerts/2018-March/base-erosion-anti-avoidance-update.ashx [https://perma.cc/4XS6-5E4N].

125. Milder, *supra* note 124.

126. H.R. Rep. No. 115-466, at 385–92 (explaining interest expense deduction limitation).

127. *Id.* at 360–67 (explaining new alternative depreciation system life).

128. *Id.* at 680–81 (describing temporary 100% bonus deprecation of business assets with a recovery period of 20 years or less).

129. *Id.* at 537–40 (describing the conference agreement to include the new Sections 1400Z-1 and 1400Z-2, which set for the new Opportunity Zones program).

130. *Id.*; Steven Bertoni, *An Unlikely Group of Billionaires and Politicians Has Created the Most Unbelievable Tax Break Ever*, FORBES (July 18, 2018), https://www.forbes.com/sites/forbesdigitalcovers/2018/07/17/an-unlikely-group-of-billionaires-and-politicians-has-

wealthy investors and corporate taxpayers to erase their tax obligations by investing recently realized capital gains into projects located in certain neighborhoods. This development incentive has very few restrictions on the type of investments eligible for the benefit and, significantly, no cap on the amount of taxes that an investor can avoid. An estimated $6.1 trillion of paper profits are eligible for the tax write-off under this program.[131] The limitless tax giveaway of the Opportunity Zones program stands in stark contrast to the LIHTC program that was not only denied a cap increase for credits but was actually undercut in terms of effectiveness by the reduced value of the credits following the 2017 tax reform.

B. Programmatic Impact from the 2018 Omnibus Spending Bill.

The Congressionally approved omnibus spending bill for fiscal year 2018 was signed into law on March 23, 2018.[132] The spending bill included two direct changes to the LIHTC program: a temporary increase in 9 percent credits allocated per capita in the states, and a change in how affordable housing properties calculate rent restrictions.[133] Both provisions had been championed by affordable housing advocates and were previously included in the proposed Affordable Housing Credit Act put forth by Sens. Maria Cantwell, D-Wash., and Orrin Hatch, R-Utah (AHCIA, S. 548, H.R. 1661).[134]

a. Temporary Increase in Credit Allocation. The 2018 Omnibus Bill included a 12.5% increase for 9 percent credit allocations over the next four years.[135] This is the first substantial allocation increase since 2000.[136] The increase is expected to boost affordable housing production by approximately 28,400 additional homes over the next

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created-the-most-unbelievable-tax-break-ever/ [http://perma.cc/DU9G-AY7B].

131. Bertoni, *supra* note 130.

132. *Appropriations for Fiscal Year 2018*, CONGRESS.GOV, https://www.congress.gov/resources/display/content/Appropriations+for+Fiscal+Year+2018 [http://perma.cc/DYC4-H8CZ] (last visited Nov. 2, 2018).

133. Michael Novogradac, *Affordable Housing Provisions in Omnibus Bill an Important Down Payment, not a Complete Fix*, NOVOGRADAC & CO. LLC (Mar. 27, 2018), https://www.novoco.com/notes-from-novogradac/affordable-housing-provisions-omnibus-bill-important-down-payment-not-complete-fix [http://perma.cc/QU86-WZ7E].

134. Affordable Housing Credit Improvement Act of 2017, S. 548, 115th Cong. § 309 (2017); Affordable Housing Credit Improvement Act of 2017, H.R. 1661, 115th Cong. § 209 (2017). The AHCIA would have increased available credits by 50%, significantly more than the increase provided in the 2018 Omnibus Bill, which would have resulted in the additional construction of 350,000 to 400,000 affordable units over the next ten years. Boyack, *supra* note 22, at 140; CANTWELL, *supra* note 34, at 2.

135. Consolidated Appropriations Act, 2018, Pub. L. No. 115-141, § 102, 132 Stat. 348, 1157.

136. *Affordable Housing Resource Center*, *supra* note 82.

decade, making up only 12% of the affordable rental housing development that was lost as a consequence of the Tax Cuts and Jobs Act.[137] Without an act of Congress, this boost will expire after four years.[138]

b. Changed Formula. The second major change to the LIHTC program from the 2018 Omnibus Bill was the additional formula for calculating rental rate restrictions for compliance with the program. The complex "Income Averaging" formula allows more flexibility for developers to offer rental rates to very low-income tenants while still retaining financial viability of the housing development.[139] The new provision overcomes a serious affordable housing obstacle faced by affordable housing developers: the programmatic restrictions on building "affordable" rental units.

Unlike other federal housing certificate programs which calculate rental rates based on an individual tenant's income, LIHTC properties set rental rates based on area median income under a statutorily defined formula.[140] Calculating rental rates based on area median incomes serves to account for wide variations in incomes between regions, but a region's incomes are not always correlated with costs.[141] Prior law provided for two formulas. Under the "20-50" formula,[142] a minimum of 20 percent of the project's rental units must be rented by tenants with incomes of at least 50 percent or less of the area median gross income, adjusted for family size.[143] Under the "40-60" formula,[144] a minimum of 40 percent of the project's rental units must be rented by tenants with incomes of at least 60 percent or less of the area median gross income, adjusted for family size.[145] Accordingly, tenants of the housing units must have incomes below

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137. Novogradac, *supra* note 133.

138. Consolidated Appropriations Act § 102, 132 Stat. at 1157.

139. Mark Shelburne & Thomas Stagg, *Implementation of LIHTC Income Averaging*, NOVOGRADAC & CO. LLP (Apr. 3, 2018), https://www.novoco.com/notes-from-novogradac/implementation-lihtc-income-averaging [http://perma.cc/7BXA-7DQ3].

140. KEIGHTLEY, *supra* note 71, at 3. Definitional standards for determining the area median gross income for the location of an affordable housing development are set forth in I.R.C. § 42(g) (2012).

141. Boyack, *supra* note 25, at 460. Area median income measures are available through the Census Bureau. Gloria G. Guzman, U.S. Census Bureau, *Household Income 2017: American Community Survey Briefs* (2017), https://www.census.gov/content/dam/Census/library/publications/2018/acs/acsbr17-01.pdf [http://perma.cc/V9L3-MZWB].

142. I.R.C. § 42(g)(1)(A).

143. KEIGHTLEY, *supra* note 71, at 3.

144. I.R.C. § 42(g)(1)(B).

145. KEIGHTLEY, *supra* note 71, at 6. Under either formula, a housing project must also meet the "gross rents test" by ensuring that rents do not exceed 30% of the overall gross median income of either 50% or 60%. *Id.*; I.R.C. § 42(g)(2).

the "qualifying level" (either 50 or 60 percent of the area's median gross income) but may have to pay well above an affordable rate of 30% of their actual income.[146]

For example, the current median household income for an individual in Houston, as calculated by HUD, is $74,900.[147] For a "40-60" housing project in Houston, 40% of the units must be rented out to individuals who make less than 60% of the area median rate, or under $44,940/ year ($3,745/month). The 40% units are in compliance with the rent restrictions so long as rent is set at or below $1,123.50/ month which would be 30% of this "qualifying level." Under this arrangement, imagine a single woman who earns an average annual salary of $26,420 ($2,201.65/month) from her job as a store clerk.[148] She could easily qualify for a unit because her income falls under the 60% area median income level, but she would actually pay more than 50% of her income on rent.

The majority of all tenants in LIHTC properties have incomes below 40% of the area median income and thereby pay rental rates that are not "affordable" for their income level.[149] The "massive gap" between actual rent at LIHTC properties and what tenants can afford is sometimes filled by additional housing assistance in the form of housing vouchers, yet most tenants simply pay more than they can afford in rent.[150] It is estimated that 38%of tenants in LIHTC properties utilize additional rental assistance resources from federal, state, or local sources.[151] Families that pay more than 30% of income on rent must choose to cut out other basic necessities such as food, healthcare, and transportation.[152]

Developers, previously constrained by the two rent restriction formulas, could not offer rental rates that would be affordable for the lowest income tenants while still ensuring that the housing projects were financially viable. Although the competitive application process

146. *See supra* note 48 and accompanying text for a description of HUD's 30% affordability standard. While HUD continues to calculate affordability using the 30% standard, alternative approaches have been proposed to more accurately discern affordable cost of living standards for a minimum standard of living which suggest that extremely low-income households cannot even afford 30%. *See* AURAND ET AL., *supra* note 52, at 7.

147. *FY 2018 Income Limits Documentation System, Median Family Income Calculation Methodology for Houston Metro Area*, HUD, https://www.huduser.gov/portal/datasets/il/il2018/2018MedCalc.odn [http://perma.cc/VQZ6-LATQ] (last visited Nov. 2, 2018).

148. *Clerk Salaries in Houston, TX*, GLASSDOOR, https://www.glassdoor.com/Salaries/houston-clerk-salary-SRCH_IL.0,7_IM394_KO8,13.
htm [http://perma.cc/M8NS-5UZR] (last updated Nov. 2, 2018).

149. BUILDING AFFORDABLE HOUSING, *supra* note 37.

150. Mallach, *supra* note 56, at 96.

151. AMERICA'S RENTAL HOUSING 2017, *supra* note 8, at 33.

152. STATE OF THE NATION'S HOUSING 2017, *supra* note 6, at 33.

for credits incentivizes developers to design properties with lower rates than the baseline requirements, typical housing produced is affordable to households that earn approximately 30% to 60% of area median income, not the lowest-income earners.[153] The new formula permits LIHTC properties to rent units at higher rates to individuals with incomes up to 80% of the area median income (still considered to be low-income) in order to offset lower rents provided to households with incomes as low as 20% of the area median income.[154] The income averaging approach has been championed by housing advocates and is expected to provide housing solutions to very low-income tenants who do not have supplemental rental assistance.[155] However, the income averaging structure is not expected to provide significant increases in the number of affordable housing units that will be built.[156]

IV. ADDITIONAL PROGRAMMATIC OBSTACLES

One takeaway from the program description above is that most of the decisions that go into planning affordable housing fall to the developers. Before submitting an application to a State Housing agency for the LIHTCs, developers are charged with conceiving a project, obtaining all the requisite financing, and selecting the site.[157] Although the program gives developers much creative control over affordable housing projects, many tensions and obstacles still serve to thwart developer efforts from carrying out the policy goals of the program. In addition to navigating the most recent changes to the LIHTC program and the anticipated reduction in equity investment and credit allocations described above, developers face programmatic challenges. For example, because of funding uncertainties, developers face challenges in planning. Programmatic regulatory costs and lack of oversight undermine program efficiencies. Also, developers face many challenges in property acquisition. This Part will explore various programmatic obstacles faced by developers who participate

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153. Kirk McClure, *Are Low-Income Housing Tax Credit Developments Locating Where There is a Shortage of Affordable Units?*, 20 HOUSING POL'Y DEBATE 153, 156 (2010).

154. Shelburne & Stagg, *supra* note 139.

155. *The Affordable Housing Credit Improvement Act of 2017 (S. 548)*, AFFORDABLE RENTAL HOUSING A.C.T.I.O.N., https://static1.squarespace.com/static/566ee654bfe8736211c559eb/t/58c001ed579fb364709b7719/1488978414769/AHCIA+comprehensive+summary.pdf [http://perma.cc/4HJG-9ES5] (last visited Nov. 2, 2018) [hereinafter *Improvement Act*].

156. Novogradac, *supra* note 133.

157. *See* KEIGHTLEY, *supra* note 71, at 2 (describing how developers must propose plans to state agencies before receiving credits). For examples of state QAPs that require fully developed housing development plans that include financing, project details, and location, each state QAP is available on its website. A full listing of all state QAPs is available through HUD's Database: List of LIHTC-Allocating Agencies, https://lihtc.huduser.gov/agency_list.htm [http://perma.cc/LLU2-HHRL].

in the LIHTC program. Land acquisition challenges will be explored in Part V.

A. Uncertain Funding for Additional Capital Investment

High demand for LIHTCs results in a very competitive process which could potentially divert money and resources away from funding the actual development of housing. Demand for LIHTCs outstrips supply in every state surveyed.[158] The state agencies that distribute LIHTCs to developers regularly receive applications for the credits at a rate double or triple the number of annual allocations, and in some cases the oversubscription rate is as high as 5 to 1.[159] With the exception of annual inflation adjustments and the most recent temporary allocation increase, Congress last increased the allocation cap in 2000 even though the population of renters across the country has grown at an increasing rate.[160] More substantial credit allocations, such as the 50% increase proposed by the Affordable Housing Credit Improvement Act of 2017,[161] would result in the additional construction of 350,000–400,000 affordable units over the next ten years.[162] Although increased distribution of credits will result in a higher tax expenditure (a revenue loss for the U.S. Treasury), the program's expense to stimulate the production of rental housing would still be billions of dollars below the high expenditures arising from homeownership policies in the tax code such as the mortgage interest deduction.[163] Adjusting government expenditures to more equally support both renters and owners may achieve more economic equality in the tax code and could stimulate the creation of more jobs. Prior to the implementation of the changes to the program arising from tax reform and the 2018 Omnibus Bill, LIHTC development supported around 95,700 jobs and over $9 billion in wages and business income.[164] An influx of credits available to developers would create more jobs and could relieve the market strains on development following the drop in the value of LIHTCs from change in the corporate tax rate.[165]

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158. Michael Novogradac, *In Demand: Allocation Ratios Show Strong Interest in LIHTCs*, NOVOGRADAC & CO. LLP (Mar. 3, 2014, 12:00 AM), https://www.novoco.com/notes-from-novogradac/demand-allocation-ratios-show-strong-interest-lihtcs [http://perma.cc/5UCN-3QM4].

159. *Id.*

160. *Affordable Housing Resource Center*, *supra* note 82.

161. CANTWELL, *supra* note 34, at 2.

162. Boyack, *supra* note 22, at 140; CANTWELL, *supra* note 34, at 2.

163. OFFICE OF MGMT. & BUDGET, *supra* note 24, at 131–36.

164. CANTWELL, *supra* note 34, at 6.

165. *See* Novogradac, *supra* note 114 (discussing the reduced equity in LIHTC linked

Historically, in addition to the lack of sufficient LIHTCs, developers also faced challenges in obtaining other sources of government funds necessary to fully finance affordable housing projects.[166] Funding in the form of grants is available to supplement LIHTC financing for affordable housing developments. However, such grants from other federal programs have been scarce.[167]

The HOME Investment Partnership program is a federal block grant that provides funds to state and local governments that use the money in collaboration with nonprofit groups to build and rehabilitate affordable housing.[168] The Community Development Block Grant Program (CDBG) similarly provides grants directly to states to address "a wide range of unique community development needs" including the development of affordable housing.[169] Congress recently provided significant funding boosts to both HOME (43.4% funding increase) and CDBG (7.8% funding increase) in the 2018 Omnibus Bill.[170] Other housing programs also received a boost in funding including "demand side" tenant-based programs such as Housing Choice Vouchers.[171] The Trump administration's proposed budget for 2019 claws back many of the 2018 funding increases.[172] While the recent HUD funding increases are a victory for developers faced with cobbling together various funding sources to supplement the 30% or 70% equity from the LIHTC program, planning for future developments will be challenging so long as additional funding sources are uncertain.

B. Regulatory Costs and Lack of Oversight

Some regulatory compliance costs divert funding away from the actual creation of affordable units. Meanwhile, lack of oversight makes it difficult for developers and investors to understand the

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to lowering the corporate tax rate).

166. Boyack, *supra* note 22, at 142–46.

167. *Id.* at 145–46.

168. *Home Investment Partnerships Program*, HUD EXCHANGE, https://www.hudexchange.info/programs/home/ [http://perma.cc/X8P3-XB8P] (last visited Nov. 2, 2018).

169. COMMUNITY DEVELOPMENT BLOCK GRANT PROGRAM–CDBG, HUD, https://www.hud.gov/program_offices/comm_planning/communitydevelopment/programs [http://perma.cc/A5XZ-5FW4] (last visited Nov. 2, 2018).

170. Consolidated Appropriations Act, 2018, Pub. L. No. 115-141, § 6, 132 Stat. 348, 1017–18; Peter Lawrence, *Congress Agrees to Historic Funding for HUD in Fiscal Year 2018 Omnibus Spending Bill*, NOVOGRADAC & CO. LLP (Mar. 22, 2018, 12:00 AM), https://www.novoco.com/notes-from-novogradac/congress-agrees-historic-funding-hud-fiscal-year-2018-omnibus-spending-bill [http://perma.cc/YFX2-VZQE].

171. Consolidated Appropriations Act § 6, 132 Stat. at 1014; Lawrence, *supra* note 170.

172. OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, BUDGET OF THE UNITED STATES GOVERNMENT, FISCAL YEAR 2019 (2018); Lawrence, *supra* note 170.

community efficacy of their projects and puts the program at risk for fraud and abuse.

The tax elements and programmatic administration of the LIHTC program are governed through the IRS[173] while HUD is responsible for enforcing each LIHTC property's compliance with the Fair Housing Act.[174] Although two federal agencies jointly administer the program, minimal oversight complicates Congressional understanding of the actual efficacy of the program,[175] which puts the program at risk for serious fraud and abuse.[176] The Government Accountability Office regards the IRS, the agency responsible for the bulk of LIHTC administration, as "high-risk" due to "significant capacity challenges" and has determined that the "IRS is not well positioned to oversee LIHTC."[177] Several monitoring requirements under the program are delegated to the state agencies that administer the credits, but the IRS review of the state agencies and their QAPs "has been minimal."[178] A bill under consideration in the House Ways and Means Committee would increase IRS oversight, which could yield better insight into the true influence of the program,[179] but recent budget cuts to the IRS undercut the agency's ability to supervise the program.[180] Even though the LIHTC program was grown out of a

173. Memorandum of Understanding Among the Department of the Treasury, the Department of Housing and Urban Development, and the Department of Justice, Low Income Housing Tax Credit (Aug. 11, 2000), https://www.hud.gov/program_offices/fair_housing_equal_opp/lihtcmou [http://perma.cc/NXN3-FTQ9].

174. 42 U.S.C. §§ 3601–3619 (2012).

175. Laura Sullivan, *The Housing Fix: Housing Program Worth Billions Lacks 'Basic Accountability,' Says GAO*, NPR (Aug. 1, 2017, 6:13 PM), https://www.npr.org/2017/08/01/540960951/housing-program-worth-billions-lacks-basic-accountability-says-gao [http://perma.cc/AWM9-KP9P]. The Government Accountability Office has recommended increased funding for the IRS to oversee credit programs like LIHTC. U.S. GOV'T ACCOUNTABILITY OFF., GAO-15-330, LOW-INCOME HOUSING TAX CREDIT: JOINT IRS-HUD ADMINISTRATION COULD HELP ADDRESS WEAKNESSES IN OVERSIGHT 18, 35–36, 41, 42 (2015), https://www.gao.gov/assets/680/671419.pdf [http://perma.cc/2VZG-SPCP] [hereinafter GAO REVIEW OF LIHTC].

176. *America's Affordable Housing Crisis, supra* note 69 (describing fraudulently misallocated funds diverted away from affordable housing development efforts); Chris Edwards & Vanessa Brown Calder, *Low-Income Housing Tax Credit: Costly, Complex, and Corruption Prone*, CATO INST.: TAX & BUDGET BULL., Nov. 13, 2017, at 1, 4.

177. GAO REVIEW OF LIHTC, *supra* note 175, at Highlights, 35.

178. *Id.* at 37.

179. Missed Opportunities in Low Income Housing Act, H.R. 4358, 115th Cong. (2017). The bill, introduced by House Ways and Means Committee member John Lewis, D-Ga., would require the IRS commissioner "to report on applications for tax credits under the low-income housing tax credit program that . . . were approved but not allocated." *Id.*

180. The Internal Revenue Service's budget was cut by $1.2 billion between 2010 and 2015, and the current executive administration has called for further cuts. Sylvan Lane, *Trump Budget Cuts IRS Funding Despite Mnuchin's Call for More Staff*, THE HILL (Mar. 16, 2017, 1:28 AM), http://thehill.com/policy/finance/324236-trump-budget-cuts-irs-funding-despite-mnuchins-call-for-more-staff [http://perma.cc/V9AB-JMC2]. The budget cuts

provision of the tax code, HUD may be a more appropriate administrator given its expertise in housing compliance issues. However, HUD similarly would require more financial resources to effectively monitor and oversee the program.[181]

Another recommendation by the Government Accountability Office to improve the IRS oversight is to streamline the processes for LIHTC applicants.[182] Currently, the process to apply for and obtain tax credits through the LIHTC program is "complex and lengthy."[183] As an added benefit on top of the increased oversight, streamlining the application requirements would reduce regulatory compliance costs so that developers can maximize funding toward the actual creation of affordable units.[184]

V. Location Challenges

The location where an affordable housing development is constructed has a large impact on the overall effectiveness of the LIHTC program in relieving affordable housing needs. Because real estate market conditions differ between regions across the country, LIHTC properties have different effects on communities depending on the rental demand characteristics of each city.[185] In regions that have a great need for affordable housing, such as San Francisco or Washington D.C., a LIHTC property may provide a net benefit for the community.[186] Because rental rates are tied to area median income, many LIHTC properties offer rents very similar to market rate rents for that region.[187] In other regions where rents are more modest and demand for affordable housing is relatively low, LIHTC properties may introduce rental units with rates higher than the median market rate for the area.[188] Because of the unique makeup of each city and geographic region, a closer examination neighborhood-by-neighborhood is necessary to more accurately reveal the disparity among LIHTC properties between areas of concentrated poverty, where real estate acquisition costs are lower, and areas of high-opportunity that include better quality neighborhoods and higher real estate values.[189]

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conflict with the Government Accountability Office's recommendation for increased funding for oversight of LIHTC program. GAO REVIEW OF LIHTC, *supra* note 175, at 39.

181. GAO REVIEW OF LIHTC, *supra* note 175, at 36.
182. *Id.* at 36–38.
183. KEIGHTLEY, *supra* note 71, at 2.
184. Boyack, *supra* note 22, at 133 n.114.
185. Mallach, *supra* note 56, at 97.
186. *Id.*
187. LIHTC AT YEAR 15, *supra* note 7, at 63.
188. Mallach, *supra* note 56, at 97–98.
189. Boyack, *supra* note 22, at 141.

At the root of the question of location is a long-standing housing policy debate of whether the government should allocate scarce housing resources to build homes in low-income neighborhoods, often disproportionately occupied by nonwhite households, or whether resources should be funneled to relatively higher-income, predominantly white communities. This issue came to a head most recently in a 2015 Supreme Court case brought by the Inclusive Communities Project which sued the Texas Department of Housing and Community Affairs for its allocation of LIHTCs.[190] The United States Supreme Court's holding in *Inclusive Communities* explored evidence that administration of the LIHTC program could potentially reinforce racial segregation.[191] Without deciding the merits of the underlying claim, the Court's ruling compared the allocation of tax credits to other unlawful housing restrictions that exclude minorities and endorsed the disparate impact method of proving a violation of the Fair Housing Act.[192] In response to the ruling, HUD promulgated the Affirmatively Furthering Fair Housing rule, which requires communities to take meaningful action to decrease disparities in access to housing and increase fair housing choice.[193]

Compelling arguments for where housing resources should be allocated can be made on both sides. On one hand, an increasing amount of evidence demonstrates that life outcomes are improved when young children move to so-called "communities of opportunity."[194] On the other hand, historical disinvestment in low-income communities of color has shown to be a major factor in the persistent issues of segregation.[195] Ambiguity between policy preferences creates a special challenge for housing developers. The LIHTC program

190. Dep't of Hous. & Cmty. Affairs v. Inclusive Cmtys. Project, Inc., 135 S. Ct. 2507, 2514 (2015).

191. *Id.* at 2516–26.

192. *Id.* at 2516–25.

193. *Affirmatively Furthering Fair Housing (AFFH)*, HUD EXCHANGE, https://www.hudexchange.info/programs/affh/ [http://perma.cc/4XVF-PMKS] (last visited Nov. 2, 2018). Implementation of the rule has been delayed by the Trump administration until 2020. Emily Badger & John Eligon, *Trump Administration Postpones an Obama Fair-Housing Rule*, N.Y. TIMES (Jan. 4, 2018), https://www.nytimes.com/2018/01/04/upshot/trump-delays-hud-fair-housing-obama-rule.html [http://perma.cc/L2ZV-XMHZ].

194. *See, e.g.*, Raj Chetty, et al., *The Effects of Exposure to Better Neighborhoods on Children: New Evidence from the Moving to Opportunity Experiment*, 106 AM. ECON. REV. 855, 859–60, 880–81 (2016) (finding that moving to a lower-poverty neighborhood before the age of thirteen leads to a reduction in single parenthood rates and an increase in earnings and college attendance).

195. For a detailed account of how prior federal housing policies and practices resulted in disinvestment in low-income communities of color, see RICHARD ROTHSTEIN, THE COLOR OF LAW: A FORGOTTEN HISTORY OF HOW OUR GOVERNMENT SEGREGATED AMERICA (2017).

gives preference to developments in lower-income tracts,[196] but the Fair Housing Act regulations mandate that state agencies avoid poverty clustering through affirmatively furthering fair housing initiatives.[197]

In addition to a lack of clear policy preferences in response to this ongoing debate,[198] developers face challenges in choosing locations that satisfy QAP requirements and serve to further the goals of the LIHTC program. First, developments in median area neighborhoods fail to promote the underlying goal of the program to offer below-market rents to low-income families. Meanwhile, resistance to development in both low- and high-opportunity neighborhoods thwarts construction in the remaining neighborhoods. So where should developers build? The remainder of this section explores the land acquisition and political opposition challenges faced by developers in each area and discusses proposed solutions.

<u>Land Acquisition</u>

The LIHTC program does not subsidize the cost of acquiring land.[199] Therefore, developers are incentivized to keep land acquisition costs low and to seek other funding sources to cover this expense. Land costs are likely to be low in neighborhoods that already have low rents. Not surprisingly, a great majority of LIHTC developments are constructed in areas that have a surplus of rental units that are affordable to households with incomes in the range typically served by the program.[200] A recent study conducted by HUD revealed that in all metropolitan areas, LIHTC properties contribute to the concentration of subsidized housing, which conflicts with the agency's goal to "enhance low income households' access to a wider variety of

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196. I.R.C. § 42(d)(5)(B) (2012) (allowing an increased adjusted basis of 130% in difficult development areas).

197. *Affirmatively Furthering Fair Housing*, *supra* note 193.

198. *See supra* note 102 and accompanying text regarding the wide variance among state QAPs. *See also* Justice Kennedy's decision in *Inclusive Communities*, which expressed ambivalence about whether state investment should be directed toward urban cores or the suburbs. Dep't of Hous. & Cmty. Affairs v. Inclusive Cmtys. Project, Inc., 135 S. Ct. 2507, 2523 (2015).

199. I.R.S., I.R.C. § 42, LOW-INCOME HOUSING CREDIT 306 (Aug. 11, 2015), https://www.irs.gov/pub/irs-utl/IRC_42.pdf [http://perma.cc/H22M-W622] ("Expenses related to acquiring the land are excluded from eligible basis.").

200. Nathaniel Baum-Snow & Justin Marion, *The Effects of Low Income Housing Tax Credit Developments on Neighborhoods*, 93 J. PUB. ECON. 654, 662–64 (2009); *see also America's Affordable Housing Crisis: Challenges and Solutions: Hearing Before the S. Comm. on Fin.*, 115th Cong. 10 (2017) (statement of Kirk McClure, one of the nation's foremost experts on the LIHTC program) ("[O]ver one-half of all LIHTC units are in tracts with a surplus of more than 50 units. One-fourth of all LIHTC units are in tracts with a surplus of 200 or more units.").

neighborhoods with more desirable public services and amenities."[201] Specifically, the study revealed that LIHTC property clusters "tend to be located in more densely developed central city locations that have higher poverty rates and lower shares of non-Hispanic whites."[202]

A particularly harmful market effect of building LIHTC properties in median area neighborhoods is that housing developments funded in part by the LIHTC program displace housing units that the private market would have otherwise produced.[203] The displacement of housing that would have otherwise been built by the private market seems contrary to the legislative purpose of the program to address a "lack of decent, affordable housing."[204] The issue is not so simple. Because LIHTC properties must comply with rental rate formulas set by area median income for a period of at least 15 years, these properties could serve to hedge against rising rental rates in an area that experiences gentrification. Developers participating in the program are in a tough place. They must respond to the economic incentives embedded within the LIHTC program in order to remain economically competitive. Meanwhile, allowing those same economic forces to drive the location and cost of "affordable" housing projects reinforces economic segregation and gentrification issues that plague American cities.[205]

As noted above, factors prioritized in state QAPs greatly influence decisions by developers in designing affordable housing developments.[206] Given the competitive application process for the credits, state agencies that distribute the tax credits have the potential to adjust QAP criteria to achieve a rent advantage for tenants of LIHTC

201. CASEY J. DAWKINS, OFFICE OF POLICY DEV. & RESEARCH, HUD, EXPLORING THE SPATIAL DISTRIBUTION OF LOW INCOME HOUSING TAX CREDIT PROPERTIES 1, 35 (2011), https://www.huduser.gov/portal/publications/pdf/Dawkins_ExploringLIHT_AssistedHousingRCR04.pdf [http://perma.cc/3CP6-CZCT].

202. *Id.* at 36.

203. Michael D. Eriksen & Stuart S. Rosenthal, *Crowd-Out Effects of Place-Based Subsidized Rental Housing: New Evidence from the LIHTC Program*, 94 J. PUB. ECON. 953, 961–64 (2010). *But see* Stephen Malpezzi & Kerry Vandell, *Does the Low-Income Housing Tax Credit Increase the Supply of Housing?*, 11 J. HOUSING ECON. 360, 375–78 (2002).

204. 132 CONG. REC. 14,924–25 (1986) (statement of Sen. Kerry).

205. Lauren Anderson, *You Cannot Afford to Live Here*, 44 FORDHAM URB. L.J. 247, 275 (2017); PETER MOSKOWITZ, HOW TO KILL A CITY: GENTRIFICATION, INEQUALITY, AND THE FIGHT FOR THE NEIGHBORHOOD 205–06 (2017). Los Angeles provides an interesting case study. Rina Palta & Aaron Mendelson, *How Affordable Housing in LA Reinforces Economic Segregation*, 89.3 KPCC (Aug. 30, 2017), https://www.scpr.org/news/2017/08/30/75123/affordable-housing-in-la-reinforces-economic-segre/ [http://perma.cc/9CTZ-UYX4].

206. *See supra* note 102 and accompanying text (describing application requirements set forth by state QAPs that developers must comply with to successfully bid in the competitive application process for LIHTCs).

properties so that low-income renters could live in neighborhoods previously unavailable to them. A few states do have express requirements that recipients of LIHTCs must offer rents that are lower than rents of comparable unsubsidized properties in the local market region.[207] However, most states do not require developers to show that a rent advantage exists nor give priority to this factor.[208]

Although requiring a rent differential may effectively promote the development of housing in higher-opportunity neighborhoods, the problem and solution to the question of location is more complex. Policymakers must consider a few other potential obstacles. First, developers would still have to overcome the cost of land acquisition. Currently, many state and local governments already subsidize land acquisition costs, either through bonds paired with LIHTC projects or through local government below-market loans that are ultimately forgiven at the end of the loan term.[209] Congress has also responded to this issue by providing a 30% "basis boost" for certain properties financed with the 9 percent credit that are built in a "difficult development area," meaning that an area with high construction, land, and utility costs would be eligible for additional credit equity financing.[210] Advocates have called for an extension of the "boost" provision to properties in rural areas, developed using the 4 percent credit, and to properties where affordable housing is in very high demand due to a concentration of poverty.[211] Another creative solution to overcome the high cost of land acquisition involves supplementing the federal charitable tax deduction with an additional tax credit to incentivize

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207. Alabama and California offer helpful examples. ALA. HOUS. FIN. AUTH., 2017 HOUSING CREDIT QUALIFIED ALLOCATION PLAN 8 (2016), https://www.ahfa.com/Content/Uploads/ahfa.com/files/MF%20Allocation/2017%20docs/2017%20Housing%20Credit%20QAP%20Addendums_govapproved.pdf [http://perma.cc/5NF3-NSWQ]; CAL. CODE REGS. tit. 4, § 10325(f)(1)(B)(i) (2017).

208. Maryland, and New York provide examples. MD. DEP'T OF HOUS. AND CMTY. DEV., MULTIFAMILY RENTAL FINANCING PROGRAM GUIDE, ATTACHMENT TO MARYLAND QUALIFIED ALLOCATION PLAN FOR THE ALLOCATION OF FEDERAL LOW INCOME HOUSING TAX CREDITS 34 (2016), https://dhcd.maryland.gov/HousingDevelopment/Documents/lihtc/Final%202016%20MD%20MF%20Rental%20Financing%20Program%20Guide%20Signed%20by%20Governor%208-9-16.pdf [http://perma.cc/X88E-SE8H]; N.Y. DIV. OF HOUS. & COMTY. RENEWAL, PART 2040, LOW-INCOME HOUSING CREDIT QUALIFIED ALLOCATION PLAN § 2040.2(u)(5) (2013), http://www.nyshcr.org/Publications/QAP/LIHC-QAP-2013.pdf [http://perma.cc/C89C-9PFZ].

209. Brandon M. Weiss, *Residual Value Capture in Subsidized Housing*, 10 HARV. L. & POL'Y. REV. 521, 535 n.61, 538 (2016).

210. H.R. REP. NO. 115-466, at 540–41 (2017) (Conf. Rep.); Affordable Housing Credit Improvement Act of 2017, S. 548, 115th Cong. § 313 (2017).

211. *Improvement Act*, *supra* note 155, (explaining sections 202, 301, 309). The proposed Senate amendment to the Tax Cuts and Jobs Act would have modified the definition of difficult development area to include rural areas. H.R. REP. NO. 115-466, at 541. The amendment would also have lowered the "boost" from 30% to 25%. *Id.*

community members to donate property.[212]

<u>*Political Opposition*</u>

In order for the LIHTC program to meet the goal of providing access to otherwise unaffordable neighborhoods, policymakers must enable developers to overcome local political opposition. Even though the properties developed using LIHTCs hardly resemble the older stereotyped public housing models that have fallen out of favor, the phenomenon of Not In My Back Yard (NIMBY) has thwarted all types of affordable housing initiatives for decades.[213] Although federal fair housing laws exist to counteract exclusionary practices, higher-income white households, which have a demonstrated negative preference for proximity to LIHTC developments, wield zoning and land use powers to restrict construction of multi-family dwellings.[214] In some states, local opposition to affordable housing developments is directly reinforced through the state QAPs which give preference for development proposals that have received a favorable letter of support from the local neighborhood council.[215] Prioritization for neighborhood preferences that favor neighborhood homogeneity may conflict with the duty of state and local governments who receive federal housing assistance to affirmatively further fair housing.[216] A potential solution to the problem of local political opposition would be to prohibit local governments from interfering or opposing affordable housing development so long as LIHTC properties comply with zoning requirements of the jurisdiction.[217] However, the 2018 Omnibus Bill specifically prohibited HUD from requiring local governments to alter their zoning laws in enforcing the agency's Affirmatively Furthering Fair Housing rule.[218]

Lastly, identifying the correct location for affordable housing developments requires a nuanced and nimble approach to the issue of

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212. Andrew Spofford, *The Donation Tax Credit—a New Affordable Housing Tool for Massachusetts*, NOVOGRADAC J. TAX CREDITS, Sept. 7, 2016, at 1, https://www.novoco.com/periodicals/articles/donation-tax-credit-new-affordable-housing-tool-massachusetts [http://perma.cc/AG3P-H3WN].

213. Michael B. Gerrard, *The Victims of NIMBY*, 21 FORDHAM URB. L.J. 495, 499–500 (1994).

214. *Id.*; Rebecca Diamond & Tim McQuade, *Who Wants Affordable Housing in Their Backyard?* 2 (Nat'l of Bureau Econ. Research, Working Paper No. 22204, 2016).

215. *E.g.*, TEX. DEP'T OF HOUS. & CMTY. AFFAIRS, 2018 QUALIFIED ALLOCATION PLAN § 11.1(d)(4) (2017), https://www.tdhca.state.tx.us/multifamily/docs/18-QAP.pdf [http://perma.cc/G6KX-ANX9].

216. *See supra* note 193 and accompanying text.

217. *Improvement Act*, *supra* note 155 (explaining sections 101 and 308). This solution was proposed in the Affordable Housing Credit Improvement Act introduced by Washington Senator Cantwell and Utah Representative Orin Hatch in 2017. *Id.*; Affordable Housing Credit Improvement Act of 2017, S. 548, 115th Cong. § 208 (2017).

218. Consolidated Appropriations Act, 2018, Pub. L. No. 115-141, § 234, 132 Stat. 348, 1037.

gentrification. In some contexts, an affordable housing development in median area neighborhoods could potentially combat some of the harmful effects of gentrification. Because housing developed using the LIHTC program includes rent restriction for up to 30 years, a project developed with LIHTC today may serve to limit rental rate increases in the future when the surrounding neighborhood values cause other market-rate apartments to increase rates.

The complex and nuanced question of where an affordable housing development should be located requires creative and thoughtful solutions. But one thing is certain; the answer is not to do nothing. If affordable housing developments continue to be concentrated in areas where rental rates are similar to market rates for the neighborhood, the net benefit to the community is questionable. State allocating agencies can effectively respond by amending QAPs to incentivize developers to build in areas where low-income tenants would have a rent advantage. Without amendments to state QAPs, developers cannot develop in neighborhoods previously unavailable to low-income tenants without losing economic advantages in land acquisition.

VI. CONCLUSION

> "Taxes are what we pay for civilized society . . . ."[219]

The affordable housing crisis threatens basic notions of national civility. Our national housing policy that every American family should have a "decent home and a suitable living environment"[220] encapsulates the most ancient of human needs,[221] regardless of whether that housing is owned or rented.

The government's extensive involvement in housing policy allows it to shape America's housing circumstances through mandated outcomes to accomplish public purposes. Unfortunately, Congress missed an opportunity to respond to embedded economic shortcomings in the housing market with the 2017 tax reform. The Tax Cuts and Jobs Act largely neglected the LIHTC program and, in fact, contributed to the housing crisis by indirectly lowering the value of the credits essential to develop affordable housing. Modifications to the LIHTC program introduced by the 2018 Omnibus Spending Bill did little to rectify the expected reduction in affordable housing

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219. Compañia Gen. de Tabacos de Filipinas v. Collector of Internal Revenue, 275 U.S. 87, 100 (1927) (Holmes, J., dissenting).

220. Housing Act of 1949 § 2, 42 U.S.C. § 1441 (1949).

221. Even the earliest communities established at the end of the Stone Age have semblances of domesticity. BILL BRYSON, AT HOME: A SHORT HISTORY OF PRIVATE LIFE 28–30 (2010) (describing Skara Brae, a Stone Age village that was unearthed in the 1850s and revealed sophisticated living arrangements by ancient peoples over 5,000 years ago).

production.

Lawmakers can effectively respond to the affordable housing crisis through the LIHTC program—a tool that is already in place poised to incentivize investmet in privately developed multifamily dwellings. The program accomplishes congressional initiatives by stimulating economic development but goes further to address American housing needs. Moreover, private investments stimulated by the LIHTC program reduce overall federal costs.

By cataloging the LIHTC program's shortcomings, this Comment aims to highlight areas where reform is desperately needed. First, developers need more credits to contribute more affordable housing supply to the market. The request for more credits for affordable housing development is a small ask next to the limitless allocation of tax benefits to investors who participate in the Opportunity Zone program. Second, developers need certainty for supplemental funding sources to effectively plan future developments. A Congressional commitment toward the development of affordable housing will assure investors and developers that supplemental funding sources will be available to develop housing plans. Third, designated oversight would yield valuable data to communities about the efficacy of projects and shield federal revenue from potential fraud and mismanagement. Finally, state-allocating agencies must deliberately require affordable housing development in high-opportunity areas. This requirement would level the playing field among developers vying for LIHTCs and would affirmatively ensure that low-income families can access housing in areas where they can thrive.

The affordable housing crisis grows deeper every day as competition in the rental market is at an all-time high and millions of Americans struggle to make ends meet. Congressional and State attention to the LIHTC program will incentivize more private investment in the marketplace and will advance American housing policy.

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