MERGING THE PUBLIC AND PRIVATE: THE LIHTC PROGRAM AND A FORMULA FOR MORE AFFORDABLE HOUSING

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Abstract

Politicians have attempted to solve the affordable housing crisis plaguing the United States for decades. The policies enacted to solve the affordable housing shortage in the United States have changed over time, ranging from the government entering the business of building affordable housing to the government providing subsidies to low-income individuals. In 1986, as part of Reagan Revolution, Congress passed the Low Income Housing Tax Credit Program (LIHTC Program or Program), to provide tax credits to developers in order to incentivize them to develop affordable housing. In this note, the author discusses policies enacted by Congress, and in particular, evaluates the success of the LIHTC Program in achieving its stated purpose of meeting the American people's demand for affordable housing. Although the Program has been widely successful in creating affordable housing, it has not yet solved the affordable housing crisis.

The author concludes that, with a legislative fix, the Program can become more successful in achieving its stated purpose by expanding the eligible recipients of such credits. Specifically, a change to the laws regulating REITs that would permit REITs to pass along the benefits of low-income housing tax credits to investors has the ability to unleash a greater demand for the credits. As a result of this change, there would be a greater number of entities demanding low-income housing tax credits. The increase in demand for tax credits, under the principles of economics, would translate into a greater supply of affordable housing developments. This legislative change would stimulate REITs and other investment trusts to apply for these tax credits, thereby yielding a larger production of more affordable housing. The author concludes that this legislative fix would enable the LIHTC Program to achieve its intended purpose of solving, or at least significantly mollifying, the affordable housing crisis.

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I. Introduction

Politics coupled with economic realities have diminished the government's role in providing necessary services, such as affordable housing, to impoverished Americans.[1] As federal and states governments' influence in providing affordable housing diminish, for-profit entities and non-profit organizations have gained an increasingly important role in providing these services.[2] This, however, is not a recent phenomenon. Rather, the role of for-profit and non-profit organizations in providing affordable housing has grown substantially since the implementation of the New Deal in the 1930s when the federal government expanded its role in alleviating poverty.[3]

Federal programs in the early twentieth century used public funds to construct housing administered by local public housing authorities."[4] In the 1960s and 1970s, however, the federal government increased the private sector's role in alleviating the affordable housing crisis by creating subsidy programs for rent,[5] including Section 8 of the U.S. Housing Act of 1937,[6] and programs supporting low-income home buying.[7] In the 1980s, President Reagan signed many conservative policies into law, including the Low Income Housing Tax Credit Program (LIHTC Program or Program), which was enacted as part of the Tax Reform Act of 1986.[8] The LIHTC Program was enacted to provide fiscal relief for low-income renters by giving developers tax incentives for building or rehabilitating affordable housing.[9] The Reagan agenda involved slashing federal funds for housing programs while also increasing the

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[1] *See generally* Megan Ballard, *Profiting from Poverty: The Competition Between For-Profit and Nonprofit Developers for Low-Income Housing Tax Credits*, 55 HASTINGS L.J. 211 (2003).

[2] Zachary Goldfarb, *U.S. examines private sector's role in ensuring affordable housing*, WASH. POST (Aug. 21, 2010), http://www.washingtonpost.com/wpdyn/content/article/2010/08/20/AR2010082005734.html [https://perma.cc/F68R-BJAN].

[3] Michele Gilman, *Legal Accountability in an Era of Privatized Welfare*, 89 CAL. L. REV. 569, 581 (2001) (citing LESTER M. SALAMON, PARTNERS IN PUBLIC SERVICE: GOVERNMENT-NONPROFIT RELATIONS IN THE MODERN WELFARE STATE 15 (1995)).

[4] David Cohen, *Improving the Supply of Affordable Housing: The Role of the Low-Income Housing Tax Credit*, 6 J.L. & POL'Y 537, 537–38 (1998).

[5] *Id.* at 538.

[6] 42 U.S.C. § 1437f(o) (2012); 24 C.F.R. § 982 (2015); Cohen, *supra* note 4, at 538.

[7] 12 U.S.C. §§ 1715z-1, 1715(d)(3) (2012); Cohen, *supra* note 4, at 538.

[8] I.R.C. § 42 (2012); Cohen, *supra* note 4, at 537–38.

[9] I.R.C. § 42(f)(1); Cohen, *supra* note 4, at 541.

amount of tax credits available for private investors.[10] The purpose of the agenda was to encourage the private sector to play a more significant role in solving the affordable housing crisis.[11]

Today, politicians blame Wall Street institutions and private developers for their role in the subprime mortgage crisis and the subsequent economic turmoil over the past decade that exacerbated the affordable housing crisis.[12] However, Wall Street institutions and large private developers might now be the key ingredients for alleviating, and perhaps even solving, the affordable housing crisis, which has plagued municipal and state legislators as well as their federal counterparts for decades. Although it is undeniable that the LIHTC Program spurred greater private sector and non-profit involvement in the building of affordable housing, the LIHTC Program does not meet its stated objective of providing "a decent home and suitable living environment for every American family."[13] This failure is reflected by the fact that the number of people requiring affordable housing continues to exceed the supply of affordable housing units.[14]

This note analyzes the LIHTC Program and concludes that, although the Program has not yet achieved its stated purpose, it has the potential to stimulate the development of more affordable housing units in the future with a change to U.S. tax laws. Specifically, if Real Estate Investment Trusts (REITs) are able to pass the benefits of low-income housing tax credits (LIHTCs) on to their investors, then demand for LIHTCs and the supply of affordable housing would increase because REITs have access to a large pool of

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[10] *See* Cohen, *supra* note 4, at 538 ("With the continual decline in direct federal funding for low-income housing, the LIHTC has become a substantial housing program. In 1991, the tax expenditure for the low-income housing credit was $.6 billion, compared to the $1 billion that was spent on housing vouchers.").

[11] *See id.*

[12] *See* David Weigel, *Not much unites Democrats and Republicans. Anger at Wall Street does,* WASH. POST (Jan. 1, 2016), https://www.washingtonpost.com/politics/not-much-unites-democrats-and-republicans-anger-at-wall-street-does/2016/01/18/265998e8-bdf0-11e5-83d4-42e3bceea902_story.html [https://perma.cc/UN86-RL2C] (outlining attacks on wall street from politicians on both sides).

[13] 42 U.S.C. § 1441a(a) (2012); *see* Cohen, *supra* note 4, at 538–39.

[14] Cohen, *supra* note 4, at 540.

capital.[15] The resulting merger of private for-profit and non-profit REITs with the public LIHTC Program would make it an even more successful policy, as the new demand for credits would act as the catalyst for a greater number of affordable houses.[16]

Following this Introduction, Part II of this note defines the term "affordable housing" and identifies the affordable housing crisis. Part III of this note outlines the federal government's response to the affordable housing crisis by providing an overview of programs enacted to combat this crisis with a special emphasis on describing the LIHTC Program. Part IV of this note offers a balanced critique of the LIHTC Program, yet concludes that the Program is generally successful given how the privatization of affordable housing has increased the overall supply of affordable housing. Part V of this note explores the impact of expanding the beneficiaries capable of using LIHTCs. Specifically, Part V offers an overview of the structure of a REIT and highlights a case study that demonstrates how effective REITs can be in increasing the supply of affordable housing units. Part VI of this note argues that a policy change can enable REITs to take advantage of the benefits of LIHTCs, thereby increasing the supply of affordable housing. This policy change would consequently lessen the severity of the affordable housing crisis at a net zero sum cost to the government.

II. Understanding the Problem: Defining Affordable Housing and the Affordable Housing Crisis

A. Affordable Housing

According to the Office of Policy Development and Research at the U.S. Department of Housing and Urban Development, "affordable housing" is broadly defined as a house that costs its occupant no greater than 30 percent of said occupant's income for housing costs, including utilities.[17] This definition of affordable housing, however, is calculated according to geographical

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[15] Susan Reaman, *Can REITs Attract New LIHTC investors?*, NIXON PEABODY (May 14, 2003), http://web20.nixonpeabody.com/ahrc/Lists/Posts/Post.aspx?ID=299 [https://perma.cc/L86R-QZKD].
[16] *See infra* Part V(b).
[17] *Glossary*, U.S. DEP'T OF HOUS. & URBAN DEV., https://www.huduser.gov/portal/glossary/glossary_a.html [https://perma.cc/BF7C-49BQ].

costs of living and housing.[18] For example, in 2016, the median family income for a family of four in Chicago is $76,900.[19] Therefore, based on this income and the 30 percent guideline for affordable housing, this family would pay approximately $23,070 per year for affordable housing costs.

The Housing Act of 1937 established the 30 percent figure to determine affordability.[20] This Act established the program for public housing, which was "designed to serve those families in the lowest income group" who were unable to afford housing to "cause private enterprise in their locality . . . to build an adequate supply of decent, safe, and sanitary dwellings for their use."[21] In the original version of the Act, a person who lived in public housing paid rent that was based on an income limit such that "a tenant's income could not exceed five to six times the rent."[22] Over time, the law evolved to set a "maximum rent standard," which meant that rent "could not exceed" a percentage of a tenant's income in public housing.[23] In 1969, Congress passed the Brooke Amendment to the 1968 Housing and Urban Law Development Act, which established the rent threshold of 25 percent of family income.[24] Ultimately, in 1981, Congress increased the rent threshold percentage to the current threshold of 30 percent.[25]

Local governments estimate affordable housing rents for federal subsidy programs based on the area median income (AMI), which is the value used to define the degree of severity of low-

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[18] *See* GARY PIVO, FANNIE MAE, THE DEFINITION OF AFFORDABLE HOUSING: CONCERNS AND RELATED EVIDENCE 2 (2013), http://www.fanniemae.com/resources/file/fundmarket/pdf/hoytpivo_mfhousing_affordablehousingdef_122013.pdf [https://perma.cc/F577-NNRN].

[19] *Area Median Income (AMI) chart*, CITY CHI., https://www.cityofchicago.org/city/en/depts/dcd/supp_info/area_median_incomeamichart.html [https://perma.cc/9PBQ-KTPQ].

[20] 42 U.S.C. § 1437f (2012); MARY SCHWARTZ & ELLEN WILSON, U.S. CENSUS BUREAU, WHO CAN AFFORD TO LIVE IN A HOME?: A LOOK AT DATA FROM THE 2006 AMERICAN COMMUNITY SURVEY 1 (2008), https://www.census.gov/housing/census/publications/who-can-afford.pdf [https://perma.cc/J7S6-2GUA].

[21] § 1437f; SCHWARTZ & WILSON, *supra* note 20, at 1.

[22] § 1437f; SCHWARTZ & WILSON, *supra* note 20, at 1.

[23] SCHWARTZ & WILSON, *supra* note 20, at 1.

[24] 12 U.S.C. § 1720 (2012); SCHWARTZ & WILSON, *supra* note 20, at 1–2.

[25] 42 U.S.C. § 1437a; SCHWARTZ & WILSON, *supra* note 20, at 2.

income households.[26] The degree of severity of low-income households is classified by three categories: “low income,” “very low income,” and “extremely low income.”[27] Households are described as “low income” if they earn incomes between 50 percent and 80 percent of AMI.[28] Households are described as “very low income” if they earn incomes below fifty percent of AMI.[29] Households are described as “extremely low income” if they earn incomes less than thirty percent of AMI.[30] The majority of individuals living in or searching for public or affordable housing units earn an income that is within these three income groups.[31]

B. Defining the Problem: The Affordable Housing Crisis

In 2015, Julian Castro, the Secretary of the Department of Housing and Urban Development, labeled the lack of affordable housing for low-income individuals as the “affordable housing crisis.”[32] As of 2014, approximately eleven million households in the United States spent over 50 percent of their income on housing.[33]

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[26] Ralf Kleemann, *The Updated Area Median Income Limits Are Out*, NAT. MULTIFAMILY HOUS. COUNCIL (Mar. 12, 2015), https://www.nmhc.org/News/The-Updated-Area-Median-Income-Limits-Are-Out/ [https://perma.cc/M7BY-FXLL].
[27] 42 U.S.C. § 1437a(b)(2).
[28] *Id*.
[29] *Id*.
[30] *Id*.
[31] MATTHEW DESMOND, INST. FOR RESEARCH ON POVERTY, UNAFFORDABLE AMERICA: POVERTY, HOUSING, AND EVICTION 1 (2015), http://scholar.harvard.edu/files/mdesmond/files/fastfocus2015.pdf [https://perma.cc/XM2S-FJVC].
[32] Julián Castro, *Our National Affordable Housing Crisis*, CNN (Apr. 7, 2015), http://www.cnn.com/2015/04/07/opinions/castro-affordable-housing-crisis/ [https://perma.cc/BFT5-P94W].
[33] JOINT CTR. FOR HOUS. STUDIES OF HARVARD UNIV., THE STATE OF THE NATION’S HOUSING 4 (2016), http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/jchs_2016_state_of_the_nations_housing_lowres.pdf [https://perma.cc/G8GB-ZUK3]; Kathryn Vasel, *11 million Americans spend half their income on rent*, CNN (June 22, 2016), http://money.cnn.com/2016/06/22/real_estate/rent-affordability-housing-harvard/ [https://perma.cc/8DB3-H2N6].

This number is expected to expand by over one million households in the next decade.[34]

According to several studies, the affordable housing crisis especially impacts poor minority families, members of Generation X, and the elderly.[35] The Harvard Joint Center for Housing Policy's Housing Landscape found that in contrast to less than 20 percent of white households approximately 25 percent of African-American and Hispanic households were "severely housing-cost burdened in 2013."[36] Meanwhile, the millennial generation has earned less and has faced a higher rate of unemployment than previous generations, which means that they have "less wealth accumulated," and consequently have not been able to raise the capital to purchase a home.[37] In addition, "Gen Xers and younger baby boomers" suffered from the "Great Recession" and suffered a decline in home ownership.[38] According to the 2014 U.S. Census National Population Projections, the elderly generation is expected to grow to approximately 74 million people by 2030, which is an increase of nearly 33 million people in twenty years, which will certainly lead to

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[34] JOINT CTR. FOR HOUS. STUDIES OF HARVARD UNIV., THE STATE OF THE NATION'S HOUSING 29 (2015), http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/jchs-sonhr-2015-full.pdf [https://perma.cc/SY3E-ZJ4B]; Joseph Lawler, *Study: Affordable housing 'crisis' will get worse*, WASH. EXAMINER (Sept. 21, 2015), http://www.washingtonexaminer.com/study-affordable-housing-crisis-will-get-worse/article/2572553 [https://perma.cc/3U3J-4TDE] ("The rental crisis . . . is expected to grow 11 percent by 2025.").

[35] *See* Lawler, *supra* note 34.

[36] ALLISON CHARETTE ET AL., JOINT CTR. FOR HOUS. OF HARVARD UNIV., PROJECTING TRENDS IN SEVERELY COST-BURDENED RENTERS: 2015–2025 8 (2015), http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/projecting_trends_in_severely_cost-burdened_renters_final.pdf [https://perma.cc/3HQ7-7JDB].

[37] *Id*.

[38] Bricker, J., et al. *Changes in US Family Finances From 2010 to 2013: Evidence From the Survey of Consumer Finances*, 100 FED. RES. BULL. 4 (2014) (finding median incomes drop by 7 percent from 2010 to 2013 in households with heads aged 45 to 64); CHARETTE ET AL., *supra* note 36, at 9 (stating that this group included homeowners who may experienced foreclosures and who have fewer working years to get back on track).

an even greater shortage of affordable housing because of the already inadequate supply of such housing.[39]

The amount of affordable housing options available to low income individuals is scant given the millions of people who demand such housing.[40] One study found that there are approximately seven million affordable housing units for over eleven million low-income families and persons that demand affordable housing, which means that there is a deficit of about four million affordable houses.[41] Meanwhile, another study revealed that there is a shortage of approximately seven million affordable and available rental units for extremely low-income households.[42] Put differently, there are only thirty-one units available for every one-hundred extremely low renters.[43] In addition, individuals that earn more than the market AMI turned to renting instead of purchasing as a result of the subprime mortgage crisis, causing rent increases and making it even harder for low-income tenants to find affordable housing.[44]

III. The Government's Response to the Crisis Over Time

Traditionally, federal and state governments have alleviated the affordable housing crisis by attacking the problem from two angles. First, the federal government has provided subsidies to low-income families to lower their overhead expenses in the form of subsidy payments.[45] Second, and particularly relevant to this note,

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[39] *2014 National Population Projections: Summary Tables*, U.S. CENSUS BUREAU, http://www.census.gov/population/projections/data/national/2014/summarytables.html [https://perma.cc/J6MG-YL4H]; CHARETTE ET AL., *supra* note 36, at 8 ("[T]he population aged 65 and older is expected to jump to 74 million by 2030, an increase of 33 million in just two decades.").

[40] *See* Lawler, *supra* note 34.

[41] CHARETTE ET AL., *supra* note 36, at 4; Lawler, *supra* note 34.

[42] Press Release, Nat'l Low Income Hous. Coal., Report: Affordable Rental Hous. Still Elusive For Lowest Income Am. (Aug. 25, 2014), http://nlihc.org/press/releases/5013 [https://perma.cc/E47Z-J9QN] ("[T]here is a deficit of 7.1 million rental units affordable and available to extremely low income households, those with income at or below 30 percent of area median income.").

[43] *Id.*

[44] *Id*.

[45] Janet Stearns, *The Low Income Housing Tax Credit: A Poor Solution to the Housing Crisis*, 6 YALE L. & POL'Y REV. 203, 205 (1988).

the federal government has given tax incentives to developers to stimulate the development of affordable housing units.[46] In particular, the federal government established the LIHTC Program to extend fiscal relief to low-income renters by providing developers tax incentives for building or rehabilitating affordable housing units.[47] Although the LIHTC Program has been successful in increasing the supply of affordable housing, the sheer number of people who still demand affordable housing demonstrates that the LIHTC Program in its current form is not entirely sufficient to solve this problem.[48]

A. Overview of Governmental Programs to Solve the Affordable Housing Crisis

The federal government has enacted several types of affordable housing programs over the years in an attempt to reduce the number of individuals who seek affordable housing. This subsection will describe four federal government programs that were enacted to combat the housing crisis: (1) Section 8 Project Based Assistance, (2) Rural Section 515 loans, (3) public housing units, and (4) the LIHTC Program.

First, Section 8 Project Based Assistance is a subsidy in the form of rental assistance that helps renters pay their rent by covering rent costs exceeding 30 percent of the renter's income.[49] The Section 8 subsidy is bound to a specific housing unit for a predetermined time period set by a Housing Assistance Payment (HAP) contract.[50] The HAP contract "is an agreement between the PHA and the owner of a unit occupied by a housing choice voucher program participant."[51] These vouchers are administered by public housing

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[46] *Id*. at 209–10.
[47] Cohen, *supra* note 4, at 541–42.
[48] *See id*. at 548–49.
[49] *Common Questions About Affordable Housing*, AFFORDABLE HOUS. ONLINE, http://affordablehousingonline.com/housing-common-questions [https://perma.cc/B5TY-V3SJ]; *see* 42 U.S.C. § 1437f(d)(2)(D) (2012).
[50] § 1437f(o)(6)(B); *see Affordable Housing Frequently Asked Questions,* COAL. OF HOMELESSNESS & HOUS. IN OHIO, http://www.cohhio.org/files/pdf/Affordable%20Housing%20FAQs.pdf [https://perma.cc/82UU-PZ44] [hereinafter *FAQ*].
[51] U.S. DEPT. OF HOUS. & URBAN DEV., HOUSING CHOICE VOUCHER PROGRAM GUIDEBOOK 11-1, https://portal.hud.gov/hudportal/documents/

authorities, and allow low-income persons to select privately-owned housing.[52] The public housing authorities pay landlords the difference between 30 percent of the household income and between 80 percent and 100 percent of fair market rate, as determined by the Public Housing Agencies.[53] Low-income individuals are able choose homes from the private market and are then subsidized for most of the rent.[54] Under this program, units can be designated as affordable if not already designated as such.[55]

Second, the U.S. Department of Agriculture Rural Development Section 515 Program offers money in the form of a "direct, competitive mortgage" to "very low, low and moderate income families, elderly individuals and individuals with disabilities."[56] Eligible recipients of these loans must earn an income that does not exceed the low-income limit—between 50 percent and 80 percent AMI—plus $5,500.[57] Individuals qualify for rental assistance if they are not capable of paying rent within 30 percent of their monthly income.[58]

Third, federal, state, and local governments offer public housing for low-income persons.[59] The public housing units are constructed and operated by local government housing authorities and administered by U.S. Department of Housing and Urban Development (HUD) Rents.[60] For these public housing units, tenants pay 30 percent of their income for public housing units and the

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huddoc?id=DOC_35621.pdf [https://perma.cc/UK56-ZR8E]; *see* § 1437f(o)(6).

52 § 1437f(o)(7); *see FAQ*, *supra* note 50.

53 § 1437f(o)(2); *see FAQ*, *supra* note 50, at 3.

54 § 1437f(o)(2); *see FAQ*, *supra* note 50, at 3.

55 § 1437f(o)(7); *see FAQ, supra* note 50, at 3.

56 § 1485(a); *see FAQ*, *supra* note 50, at 1.

57 *See FAQ, supra* note 50, at 1.

58 § 1485(t)(3); *see FAQ, supra* note 50, at 1.

59 *See generally FAQ, supra* note 50 (discussing how public housing is built and managed by local governments, administered by state and federal governments).

60 *See, e.g.*, *How to Obtain Housing Assistance*, HOUS. & ECON. DEV., http://www.mass.gov/hed/economic/eohed/dhcd/how-to-obtain-housing-assistance.html [https://perma.cc/6DGE-WHF6] [hereinafter *Housing Assistance*]; *Guide to Affordable Housing in New Jersey revised April 01, 2016*, N.J. DEP'T OF CMTY AFFAIRS, http://www.state.nj.us/dca/divisions/codes/publications/guide.html [https://perma.cc/J2XQ-ANFS] [hereinafter *Guide*]; *FAQ, supra* note 50, at 1.

Annual Contributions Contract from HUD pays the balance.[61] To be eligible for public housing, a person must satisfy requirements that relate to income, age, disabled status, and citizenship, and differ by state and county.[62] For example, rent is set at 32 percent of adjusted income for a family living in Massachusetts state public housing.[63] Seniors or people with disabilities living in a Massachusetts state public housing pay rent set at 30 percent of adjusted income.[64]

Fourth, and of most relevance to this note, LIHTCs are federal tax credits administered by state agencies that are distributed to nonprofit and for-profit developers of qualified projects in order to permit owners to charge lower rental rates.[65] These tax credits allow a developer to offset the cost of building or rehabilitating affordable housing units by the amount of the tax credit.[66] This note expands in greater detail on the LIHTC Program in the following subsection.

B. Overview of the Low Income Housing Tax Program

The LIHTC Program is a "partnership between federal, state, and local governments" and the private sector, whereby tax credits are distributed through housing agencies at the state level.[67] There are three categories of buildings that qualify for LIHTCs: (1) new construction; (2) the substantial rehabilitation of rental properties;[68] and (3) buildings that are reclassified as low-income rental buildings, as long as such buildings were purchased, not previously placed in

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[61] *See, e.g.*, *Housing Assistance, supra* note 60, at 1.; *Guide*, *supra* note 60, at 1; *FAQ, supra* note 50, at 1.
[62] *See, e.g.*, *Housing Assistance, supra* note 60 at 1.; *Guide*, *supra* note 60, at 1; *FAQ, supra* note 50, at 1.
[63] *How Rent Is Set*, BOS. HOUS. AUTHORITY, http://www.bostonhousing.org/es/For-Public-Housing/Paying-Rent/How-Rent-is-Set.aspx [https://perma.cc/MK4Q-HJGU].
[64] *Id*.
[65] I.R.C. §§ 42(h), (f)(1) (2012); Sagit Leviner, *Affordable Housing and the Role of the Low Income Housing Tax Credit Program: A Contemporary* Assessment, 57 TAX LAW. 869, 871 (2004). *See, e.g., FAQ, supra* note 50 (discussing how the State of Ohio awards Low Income Housing Tax Credits to private developers).
[66] § 42(h); Leviner, *supra* note 65, at 870; *FAQ, supra* note 50.
[67] § 42(h)(3), (7); Leviner, *supra* note 65, at 871.
[68] *See* Cohen, *supra* note 4, at 541; Leviner, *supra* note 65, at 871 n.18.

service by the taxpayer, and have not changed ownership or undergone major improvements in the last decade.[69]

The LIHTC Program restricts the amount of rent that owners of affordable units may charge tenants.[70] The affordable units' gross rent, including utilities and excluding Section 8 payments, may not exceed 30 percent of the qualifying income.[71] This assures that the rent is affordable for tenants based on other factors, such as AMI or the location of the unit.[72]

Congress enacted the LIHTC Program with the objective of incentivizing developers to build or rehabilitate affordable housing for low-income families since the Tax Reform Act of 1986 eliminated favorable tax treatment for expenses incurred in the development of rental housing.[73] The enactment of the LIHTC Program lowered the cost of building affordable housing for developers, which acted as a catalyst for developers to build more affordable housing projects.[74]

1. Application Process for Receiving LIHTCs

To receive LIHTCs from the distributing state agency, a developer must complete an application for tax credits to the state agency that administers the program.[75] For-profit developers or non-profit organizations that intend to rehabilitate or build housing units for the purpose of affordable housing must draft and submit plans of the project.[76] In the plans, developers must estimate the costs of construction, including hard costs, such as materials, and soft costs, such as legal and architectural fees.[77]Additionally, developers must confirm that the number of units that will be available to low-income

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[69] *See* § 42(d); Cohen, *supra* note 4, at 541–42; Leviner, *supra* note 65, at 871 n.18.
[70] Cohen, *supra* note 4, at 542; Leviner, *supra* note 65, at 872.
[71] Cohen, *supra* note 4, at 542; Leviner, *supra* note 65, at 871–72.
[72] Cohen, *supra* note 4, at 542–43; Leviner, *supra* note 65, at 872 n.23; *see* § 42(g)(2).
[73] Cohen, *supra* note 4, at 538–39; Leviner, *supra* note 65, at 869 n.5.
[74] *See* Leviner, *supra* note 65, at 870.
[75] Ballard, *supra* note 1, at 216; *see* § 42(m)(1).
[76] Ballard, *supra* note 1, at 216.
[77] *Id*. at 217.

persons is consistent with the statutory minimum of 20 percent of total units for a period of fifteen years.[78]

Developers' plans must also identify the amount of tax credits they seek.[79] The amount of tax credits requested corresponds to the portion of the project that will be available for low-income tenants.[80] For example, if a developer plans to build a one hundred-unit building at a cost of $5 million, and 50 percent of the building is dedicated to affordable housing for the required fifteen-year term, then the developer may apply for $2.5 million in tax credits. The amount of LIHTCs the developer can apply for is 50 percent of the $5 million, which is the value that is proportional to the number of units available to low-income tenants. The tax credits, if awarded, are then distributed over a ten-year period.[81]

Additionally, developers can apply for either 4 percent or 9 percent annual tax credits.[82] Developers may be eligible for the 9 percent credits if they do not apply for and receive other federal funding for the project.[83] Meanwhile, developers can apply for the default 4 percent credits even if they anticipate applying for or receiving federal subsidies.[84] Under Section 42 of the Internal Revenue Code, a project generally relies on other federal subsidies where "there is or was outstanding any obligation the interest on which is exempt from tax under section 103 the proceeds of which are or were used (directly or indirectly) with respect to such building or the operation thereof."[85]

A building qualifies for the 4 percent or 9 percent tax credits if it contains a "minimum number of rent-restricted residential units."[86] The developer or investor of the affordable rental project must guarantee that at least 20 percent of the units are occupied by renters whose income is 50 percent of AMI or less, or must guarantee that at least 40 percent of its unites are rent-restricted and rented to

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[78] §§ 42(g)(2), (h)(6), (i)(1); *Ballard*, *supra* note 1, at 217; Leviner, *supra* note 65, at 871, 873.
[79] *See* § 42(d); Ballard, *supra* note 1, at 217.
[80] Ballard, *supra* note 1, at 217; *see* § 42(d).
[81] *See* Ballard, supra note 1, at 217.
[82] *Id*. at 218.
[83] *Id*.
[84] *Id*.
[85] § 42(i)(2)(A).
[86] § 42(g)(1); Cohen, *supra* note 4, at 542; Leviner, *supra* note 65, at 871–72.

individuals with an income no greater than 60 percent of AMI.[87] The division by percentage of the housing complex into affordable and non-affordable units and by AMI cannot change once the government awards tax credits.[88]

After administering the credit to an applicant for any given project, the state agency simultaneously reviews all of the plans submitted by both for-profit developers and nonprofit organizations, and then chooses the plan that best fits the housing needs of the community.[89] Ultimately, the developer receives the tax credits at the completion of the project if the project remains in compliance with federal law.[90] If the project fails to comply with federal law, for example, if the minimum number of affordable housing units is no longer available to low-income persons within the mandated fifteen-year term, then the credits may be recaptured.[91]

2. Tax Credit Amount

The LIHTC Program awards tax credits proportional to the percentage of the property that is accessible to low-income renters.[92] The percentage of the property that is qualified as affordable, known as the qualified basis, is calculated by multiplying a building's eligible basis by the applicable fraction.[93] The applicable fraction is either the "ratio of low-income units to total units in the building, or the floor space fraction, which is the ratio of total floor space of the low-income units to the total floor space of all residential units."[94] Common space may be included in the floor space calculation for credits.[95] The building's eligible basis, however, must be decreased to account for other federal grants awarded for the building.[96]

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87 § 42(g)(1); Cohen, *supra* note 4, at 542; Leviner, *supra* note 65, at 872 n.20.
88 Cohen, *supra* note 4, at 542.
89 *See* Ballard, *supra* note 1, at 217 n.25.
90 *Id*. at 219 ("Assuming that the project continues to operate in compliance with habitability standards, tenant income requirements, and rent caps, credits will flow for ten years.").
91 § 42(j); Ballard, *supra* note 1, at 219; Leviner, *supra* note 65, at 875.
92 Cohen, *supra* note 4, at 543.
93 Cohen, *supra* note 4, at 543; Leviner, *supra* note 65, at 872 n.24.
94 Cohen, *supra* note 4, at 543; Leviner, *supra* note 65, at 872 n.24.
95 Cohen, *supra* note 4, at 543.
96 *Id*.

Once the qualified basis is calculated, the applicable percentage is identified.[97] The applicable percentage is determined each month by the Department of Treasury and is given a value that lasts for a ten-year period.[98] This value can equal either 70 percent or 30 percent of the building's qualified basis, depending on the characteristics of the building.[99] The 70 percent value is realized for both new construction and renovated properties that do not receive other federal grants beyond LIHTCs.[100] As a result of the time value of money, the annual tax credit for these buildings equals approximately 9 percent of qualified basis."[101] Buildings that do not fall into the category of substantially renovated or new construction, or those that receive other federal grants are eligible for a credit with a present value equal to 30 percent of qualified basis, which is approximately 4 percent annually for the ten-year period.[102] In addition, the Secretary of Housing and Urban Development has the authority to designate an area where an affordable housing project is built or renovated as worthy of higher credit.[103]

3. LIHTC Period and Possibility of Credit Recapture

The period in which tax credits can be retrieved lasts ten years from when the building is accessible for occupancy.[104] To continue to receive the tax credits, the recipient must ensure that the building will remain available for low-income renters for a period of fifteen years.[105] The recipient of the tax credits must track the incomes of tenants over the fifteen-year period to ensure that the occupants satisfy the low-income requirement.[106]

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[97] *Id.* at 543; Leviner, *supra* note 65, at 872.
[98] Cohen, *supra* note 4, at 543; Leviner, *supra* note 65, at 872.
[99] Cohen, *supra* note 4, at 543; Leviner, *supra* note 65, at 872.
[100] I.R.C. § 42(b); Cohen, *supra* note 4, at 543; Leviner, *supra* note 65, at 872.
[101] Cohen, *supra* note 4, at 543.
[102] § 42(e); Rev. Rul. 1991-38, 1991-26 I.R.B. 5; Cohen, *supra* note 4, at 543; Leviner, *supra* note 65, at 873.
[103] Cohen, *supra* note 4, at 543.
[104] § 42(f); Cohen, *supra* note 4, at 545; Leviner, *supra* note 65, at 873.
[105] §§ 42(g)(2), (h)(6), (i)(1); Cohen, *supra* note 4, at 545; Leviner, *supra* note 65, at 873.
[106] §§ 42(l)(2)(C), (3)(C), (1)(E); Cohen, *supra* note 4, at 545; Leviner, *supra* note 65, at 875.

If a building no longer meets the affordable housing requirements for income and rent, the tax credits awarded may be recaptured.[107] For example, a unit can remain rent restricted if the tenant residing in the unit earns more money than typically permitted as long as the tenant originally earned an income that met the standards, and the current income "does not exceed 140 percent of the income limitation."[108] Additionally, if the recipient of the tax credits sells a stake of the property, then the credits may be recaptured.[109]

4. LIHTC Administration and Compliance

Although the tax credits utilize federal taxpayer dollars, state housing agencies actually administer the LIHTCs.[110] The LIHTC Program sets an annual credit ceiling, which is calculated by multiplying the state's population by $1.75.[111] In 1989, Congress restricted states' housing agencies discretion to distribute the funds and set priorities for credit allocation.[112] Specifically, state agencies must "establish a qualified allocation plan" that identifies standards for distributing credits, such as prioritizing hotbeds of poverty and inner cities.[113] Additionally, the qualified allocation plan must address measures of compliance, and the agency must "give preference to properties serving the lowest-income households for the longest periods."[114] Lastly, the LIHTC Program requires at least 10 percent of the state's credit to be allocated to properties in which a nonprofit organization owns an interest and significantly participates in the property's development and operation.[115]

In addition to following the stipulations above, the LIHTC Program imposes compliance requirements on state agencies and

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[107] § 42(j); Ballard, *supra* note 1, at 219; Cohen, *supra* note 4, at 546; Leviner, *supra* note 65, at 875.
[108] §§ 42(g)(2)(D), (i)(2)(E), (j); Cohen, *supra* note 4, at 546; Leviner, *supra* note 65, at 875 n.54.
[109] § 42(j); Ballard, *supra* note 1, at 219; Leviner, *supra* note 65, at 875.
[110] *See Housing Credit*, NAT'L COUNCIL STATE HOUS. AGENCIES, https://www.ncsha.org/advocacy-issues/housing-credit [https://perma.cc/87KB-YWMB].
[111] § 42(h)(3)(C)(ii)(I); Leviner, *supra* note 65, at 874.
[112] Leviner, *supra* note 65, at 874.
[113] § 42(m); Leviner, *supra* note 65, at 874.
[114] Leviner, *supra* note 65, at 874.
[115] *Id*. at 874–75.

private owners.[116] State agencies must "provide the Treasury with an annual report specifying the amount and recipients of credit allocations and to provide such other information as the Treasury may require" and private persons must submit a certification establishing that they meet the Treasury's required criteria.[117] According to federal law, state agencies must audit 20 percent of the properties every three years to ensure tenants' income remains low-income[118] and must inspect the housing facilities within two years of completion to ensure that they meet the mandated standards.[119]

The LIHTC Program, therefore, incentivizes developers to construct or rehabilitate affordable housing with a tax credit as opposed to distributing money to low-income persons for housing.[120] While the LIHTC Program is successful from a budget perspective, it is unsuccessful in solving the affordable housing crisis, which is examined in the following section.

IV. Building on the Success of the LIHTC Program

A. Overview of Governmental Programs to Solve the Affordable Housing Crisis

Although the LIHTC Program does not fulfill its broad purpose of eliminating the demand for affordable housing, it has helped manage the affordable housing crisis.[121] The LIHTC Program is a supply-side policy, which is a policy that aims to "increase the physical supply of affordable rental housing through production incentives . . . ."[122] Meanwhile, demand-side policies aim to "reduce

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[116] §§ 42(l)(3)(C), (2)(C), (1)(E); Leviner, *supra* note 65, at 875.
[117] Leviner, *supra* note 65, at 875.
[118] *Id.*
[119] *Id.*
[120] *Id.* at 870.
[121] *See Low Income Housing Tax Credit*, NAT'L ASS'N HOME BUILDERS, https://www.nahb.org/en/research/nahb-priorities/low-income-housing-tax-credit.aspx [https://perma.cc/BKM8-5269]; NOVOGRADAC & CO. LLP, LOW-INCOME HOUSING TAX CREDIT ASSESSMENT OF PROGRAM PERFORMANCE & COMPARISON TO OTHER FEDERAL AFFORDABLE RENTAL HOUSING SUBSIDIES 1 (2011), https://www.novoco.com/sites/default/files/atoms/files/novogradac_hag_study_2011_graphics.pdf [https://perma.cc/K5BF-2QWT] (summarizing the LIHTC's "successful track record" in incentivizing development and maintenance of affordable housing).
[122] NOVOGRADAC & CO. LLP, *supra* note 121, at 2.

the cost of rental housing to low-income families through direct tenant-based rental subsidies."[123] There are several indicators to evaluate the general success of the LIHTC Program, as a supply-side policy, including: foreclosure rate, compliance history, credit allocating agency review experience, year fifteen opt-outs, and investor portfolio analysis.[124]

First, the foreclosure rate is an important tool to assess the success of the LIHTC Program because nearly all affordable housing projects that utilize tax credits are also financed by mortgage debt.[125] Wherever debt is involved, there is a risk of foreclosure, so, a low foreclosure rate indicates that affordable rental housing is being subsidized and is not being lost to foreclosure.[126] A subsidized property not lost to foreclosure remains available to low-income renters.[127] Research shows that "[t]he LIHTC [P]rogram has experienced a significantly low foreclosure rate relative to other real estate asset classes," which suggests that the affordable housing projects are managed efficiently and effectively.[128] According to an Ernst & Young survey, between the years 1991 and 2006, 0.08 percent of LIHTC properties were foreclosed annually compared to 0.27 percent for non-LIHTC apartment properties.[129] Therefore, based on the foreclosure rate measure, the LIHTC Program appears to be a success.

Second, compliance history, as measured by the number of tax credit recaptures, is another tool to determine the success of the LIHTC Program.[130] The number of tax credit recaptures reveals the frequency with which affordable units are rented to non-qualifying tenants.[131] Despite the lack of publicly available statistics, "it appears that the LIHTC [P]rogram has experienced extremely low levels of tax credit recapture during its history, and the Internal Revenue Service (IRS) has generally found very good compliance by LIHTC

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[123] *Id*.
[124] *Id*. at 3.
[125] *Id*. at 4.
[126] *Id*.
[127] *Id*.
[128] *See id*.
[129] ERNST & YOUNG, UNDERSTANDING THE DYNAMICS V HOUSING TAX CREDIT INVESTMENT PERFORMANCE 3, 41 (2010); NOVOGRADAC & CO. LLP, *supra* note 121, at 4.
[130] NOVOGRADAC & CO. LLP, *supra* note 121, at 4.
[131] *Id*.

properties with the program requirements."[132] These findings provide additional evidence that the LIHTC Program is successful.

Third, the success of the LIHTC Program can be analyzed by looking at reviews undertaken by credit allocating agencies.[133] Credit allocating agencies are "responsible for allocating their geographic area's pro rata share of LIHTC on an annual basis and [are] able to set preferences for affordable rental housing development by emphasizing or de-emphasizing certain items in its qualified allocation plan (QAP)."[134] Novogradac & Company reported that units created under the LIHTC Program typically comply with requirements set by credit allocating agencies.[135] For example, data reveals that only "a small percentage of properties [in California] have received noncompliance notifications."[136] Only about 5 percent of the active properties in California received an IRS Form 8823, which the government usually sends because of minor paperwork infractions, relating to issues including income, maintenance, and physical conditions.[137] Because credit allocating agencies have generally found that the affordable properties are in compliance, the LIHTC Program is successful on this basis as well.

Fourth, the number of properties that remain income-restricted after fifteen years is another measure used to determine the success of the LIHTC Program.[138] Because many credit allocating agencies require property owners to waive the opt-out option that permits the owner of the affordable unit to rent it at market rate prices after fifteen years, "a majority of LIHTC affordable rental housing stock is preserved for 30 years or longer."[139] One study found "approximately 5% of properties reaching Year 15 are converted to market rate housing. . . . 42% of the properties were re syndicated with tax credits to rehabilitate the property. . . . 15% are maintained as affordable rental housing and refinanced without tax

132 *Id.*
133 *Id.*
134 *Id.*
135 NOVOGRADAC & CO. LLP, *supra* note 121, at 4.
136 NOVOGRADAC & CO. LLP, *supra* note 121, at 4–5.
137 *Id.* at 5.
138 *Id.* at 5–6.
139 NOVOGRADAC & CO. LLP, *supra* note 121, at 5; U.S. GEN. ACCOUNTING OFFICE, GAO/GGD/RCED-97-55, OPPORTUNITIES TO OVERSIGHT OF THE LOW-INCOME HOUSING PROGRAM 66 (1997), http://www.gao.gov/assets/160/155820.pdf [https://perma.cc/9C78-ST8D].

credits. . . . and [a]pproximately 38% pursued other disposition options."[140] Accordingly, LIHTC-subsidized properties remain affordable for an extended period of time, supporting the conclusion that the LIHTC Program is successful in providing low-income individuals with housing.[141]

Finally, another measure used to examine the success of the LIHTC Program is investor portfolio analysis.[142] Since the cost associated with a LIHTC property failing to maintain its affordable status for investors diminishes the value of the tax credits, an investor tends to take any measure necessary to avoid foreclosure and maintain the property as affordable rental housing, such as becoming the property manager or hiring another property manager.[143] These operational "risk mitigating features" make the LIHTC Program a more safe and predictable investment,[144] as evinced by the difference between projected yield and actual yield of LIHTC investment.[145] In 2006, this yield variance value was 0 percent.[146] As a result, "investors and developers have become more sophisticated and have streamlined their processes," which has "led to more competition and thus, higher credit prices."[147] This means that private investors rather than the government are funding more of the affordable developments and assuming the risks.[148] This measure further proves

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[140] DIXON HUGHES GOODMAN LLP, LOW-INCOME HOUSING TAX CREDITS AND PLANNING FOR YEAR 15, 18 (2015), http://vahousingalliance.org/wp-content/uploads/2015/12/shawn-harrigan.pdf [https://perma.cc/R5VZ-2HQN]; NOVOGRADAC & CO. LLP, *supra* note 121, at 5–6.
[141] NOVOGRADAC & CO. LLP, *supra* note 121, at 5–6.
[142] *Id.*
[143] *Id.*
[144] *Id.* at 6.
[145] *Id.* at 6–7.
[146] *Id.*
[147] *Id.*; OFFICE OF THE COMPTROLLER OF THE CURRENCY, LOW-INCOME HOUSING TAX CREDITS: AFFORDABLE HOUSING INVESTMENT OPPORTUNITIES FOR BANKS 24 (2014), https://www.occ.gov/topics/community-affairs/publications/insights/insights-low-income-housing-tax-credits.pdf [https://perma.cc/KP8F-6LBH].
[148] JOINT CTR. FOR HOUS. STUDIES OF HARVARD UNIV., THE DISRUPTION OF THE LOW INCOME HOUSING TAX CREDIT PROGRAM: CAUSES, CONSEQUENCES, RESPONSES, AND PROPOSED CORRECTIVES 2 (2009), http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/disruption_of_the_lihtc_program_2009_0.pdf [https://perma.cc/52M8-U6T5]; NOVOGRADAC & CO. LLP, *supra* note 121, at 6–7.

that the LIHTC Program has successfully incentivized developers and investors to fund affordable housing units.[149]

B. Proponents of the LIHTC Program

Proponents of the LIHTC Program point to the aforementioned five factors in concluding that the Program is a success.[150] However, opponents claim that assessing the effectiveness of the Program based on the five factors is speculative at best because there is insufficient public data on LIHTCs.[151] A study conducted in the 1960s through the late 1970s found that 85 percent of subsidized housing might have displaced unsubsidized units rather than adding to the supply of affordable housing.[152] This study lends support to the notion that the housing created by subsidies would have been built regardless of the Program given the demand pressures on the private market.[153] Therefore, the Program is most effective when "it is less likely to displace otherwise planned activity" and will yield a net gain of affordable housing.[154]

Moreover, some argue that it is difficult to evaluate the effectiveness of the Program because developers would have rehabilitated existing units or built new units for the purpose of affordable housing regardless of the Program.[155] Still others find the Program fails to solve the affordable housing crisis when many renters spend over 50 percent of their income on housing, which is above the thirty percent amount deemed affordable by the government.[156]

Despite such criticisms, the efficacy and results of the Program were reversed by the subprime mortgage crisis of 2007–2008.[157] The primary LIHTC investors before the crisis were banks

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[149] *See generally id.*
[150] *See, e.g.,* NOVOGRADAC & CO. LLP, *supra* note 121.
[151] Leviner, *supra* note 65, at 876 n.61.
[152] STAFF OF JOINT COMM. ON TAXATION, 102ND CONG., 2ND SESS., DESCRIPTION AND ANALYSIS OF TAX PROVISIONS EXPIRING IN 1992 78 (Comm. Print 1992); *see* Leviner, *supra* note 65, at 876.
[153] Leviner, *supra* note 65, at 876.
[154] *Id.*
[155] *Id.* at 877.
[156] *Id.*
[157] Sarah Pickering, Note, *Our House: Crowdfunding Affordable Homes with Tax Credit Investment Partnerships*, 33 REV. BANKING & FIN. L. 937, 960 (2014).

and government sponsored enterprises (GSEs), such as Fannie Mae and Freddie Mac.[158] These institutional investors were well equipped to manage long-term, illiquid investments in the real estate sector.[159] Banks also favored investing in tax credits, including LIHTCs, because it allowed them to both balance and sustain short-term deposits with long-term investments.[160] Additionally, banks favored purchasing LIHTCs over other investments because such investments garner favorable treatment under the Community Reinvestment Act and satisfy GSEs' regulatory purposes.[161]

With the onset of the financial crisis, however, banks and GSEs recognized their tax liability risk.[162] The economy's impact on these institutional investors was passed onto developers, who depended on capital investments that ultimately were not realized because the amount of capital was based on pre-crisis LIHTC pricing.[163] Consequently, developers abandoned their plans to continue building affordable housing projects.[164] The effects of the subprime mortgage crisis were not fleeting, and have lasted years beyond the onset of the crisis.[165] Specifically, despite the economic recovery, institutional investors altered their calculus with regards to the amount they would lend developers.[166] Since GSEs became aware of their tax liability risk, and lowered their income expectations, they became unlikely to invest in LIHTCs again.[167] The effectiveness of the Program in solving the affordable housing crisis has therefore been eroded by the subprime mortgage crisis and subsequent recession.

The LIHTC Program's efficiency in assuaging the affordable housing crisis is another measure to determine its success. Under the Program, most of the affordable housing projects built are new

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158 *Id.*
159 *Id.*
160 *See id.* at 960–61.
161 *Id.* at 961–62.
162 *Id.* at 966.
163 *Id.*
164 *Id.* (describing how developers had to strand "once-healthy projects" because they did not have sufficient financing).
165 *The Origins of the Financial Crisis Crash Course*, THE ECONOMIST (Sept. 7, 2013), http://www.economist.com/news/schoolsbrief/21584534-effects-financial-crisis-are-still-being-felt-five-years-article [https://perma.cc/5UT5-6Q4W].
166 *See* Pickering, *supra* note 157, at 967.
167 *Id.* at 967–98.

construction units as opposed to rehabilitated units.[168] The new construction units do not parallel the needs of low-income family tenants because they are not large units.[169] This problem stems directly from the LIHTC Program, which make it cost-efficient to build units with fewer bedrooms than what a typical low-income family would normally need.[170] Furthermore, the Program promotes affordable "housing [that] may be of higher quality or quantity than needed.[171] Developers typically favor larger projects because that enables them to lower the cost per unit by spreading the cost across all the units despite the building being inefficient with regards to the tenants' needs.[172]

According to Abt Associates'[173] reports issued in 2002 and 2003, "properties placed in service between 1995 and 2001 became unexplainably larger than properties placed in service between 1987 and 1994, consisting of an average of 73.9 apartments in 2001 and 73 in 1999, compared with 42 apartments in 1995."[174] Moreover, LIHTCs funds typically are granted to new construction projects, the most expensive source of housing supply.[175] In the absence of LIHTC funds, the supply of affordable housing units would probably consist of mainly rehabilitated units, making housing production under the LIHTC "more capital-intensive than it otherwise would be."[176] LIHTC funds are therefore inefficient, since such capital

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[168] Leviner, *supra* note 65, at 877–78.
[169] *Id.* at 878 (acknowledging that while low-income families are "often quite large," the units created under the program are too small to accommodate the larger households).
[170] *Id.*
[171] *Id.*
[172] *Id.*
[173] Abt Associates is a public policy and business research consulting firm. *See* ABT ASSOCS., http://www.abtassociates.com/ [https://perma.cc/Q9MH-2PD4].
[174] ABT. ASSOCS., UPDATING THE LOW INCOME HOUSING TAX CREDIT (LIHTC) DATABASE: PROJECTS PLACED IN SERVICE THROUGH 1999 ii (2002), http://www.abtassociates.com/AbtAssociates/files/48/48267d71-7b2a-4035-9675-e83eda8f6ac1.pdf [https://perma.cc/7A7F-36HR]; ABT. ASSOCS., UPDATING THE LOW INCOME HOUSING TAX CREDIT (LIHTC) DATABASE: PROJECTS PLACED IN SERVICE THROUGH 2001 ii (2003), http://www.abtassociates.com/reports/2003630111505_16197.pdf [https://perma.cc/8DE8-46F8]; *see* Leviner, *supra* note 65, at 878.
[175] Leviner, *supra* note 65, at 878.
[176] *Id.*

could have been invested in a more frugal manner elsewhere, such as rehabilitating a greater number of affordable units that would better meet the demands of the community.[177]

C. Criticism of the LIHTC Program

The law establishing the LIHTC Program offers minimal incentives to for-profit developers to provide affordable housing to extremely poor individuals.[178] For example, developers have two options regarding the composition of the affordable housing units.[179] Developers can provide a maximum of 20 percent of the rental units constructed or rehabilitated to tenants with incomes equal to or less than 50 percent of area median income (AMI).[180] Alternatively, developers may dedicate 40 percent of the units to tenants who earn an income of 60 percent or less of AMI.[181] Facing these two options, for-profit developers overwhelmingly choose the latter, which allows developers to maximize profits by renting the units to tenants with higher incomes.[182] This is true except for projects located in a "difficult development area," which is a place where there are steep costs to enter the market relative to AMI.[183] Under the law establishing the Program, developers are incentivized with additional tax credits to rent to tenants with an AMI that is less than 50 percent in these difficult development areas.[184] Because these projects are not as advantageous for for-profit developers, non-profit developers tend to build affordable housing projects in such areas.[185] Therefore, developers and for-profit entities do not have any significant financial incentives to build affordable housing for tenants who earn less than 50 percent of AMI.[186] Ultimately, for-profit developers receiving tax credits have profit-based motivations and must charge higher rents than non-profit developers.[187]

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[177] *Id.*
[178] Ballard, *supra* note 1, at 229.
[179] *Id.*
[180] *Id.*
[181] *Id.* at 229–30.
[182] *Id.* at 230.
[183] *Id.*
[184] *Id. See generally* I.R.C. § 42 (2012).
[185] Ballard, *supra* note 1, at 231.
[186] *Id.*
[187] *Id.* at 233.

Non-profit organizations, however, are not incentivized by the same profit driven motives as for-profit developers.[188] Specifically, non-profit developers are willing to rent to tenants who earn less than 50 percent of AMI.[189] A HUD survey revealed that the "rents in the nonprofit properties are substantially lower than in the for-profit properties."[190] In short, non-profit developers are not faced with the same needs for a return on investment that for-profit developers have.[191]

For-profit developers, however, have greater access to "ready capital" than non-profit developers.[192] While for-profit developers use conventional loans to finance their affordable housing units, nonprofit developers often rely on federal programs designed to alleviate the affordable housing crisis.[193] Also, nonprofit developers are more inclined than for-profit developers to "use multiple sources to make the deals work," including a variety of state and federal grants as well as private donations.[194] In addition to not having access to the same sources of capital, nonprofit developers often have production costs that exceed those of their for-profit counterparts.[195] This is, in part, because of the nature and geography of the actual projects that nonprofit developers focus on, which differ from those projects that for-profit developers construct.[196]

Although there is some dispute about whether for-profit developers have lower management and operation costs, the number of affordable units actually built by for-profit and non-profit developers is concrete.[197] According to the HUD LIHTC database,[198]

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188 *Id.* at 231.
189 *Id.*
190 *Id.* at 232 (quoting Larry Buron et al., U.S. DEP'T OF HOUSING & URBAN DEV., ASSESSMENT OF THE ECONOMIC AND SOCIAL CHARACTERISTICS OF LIHTC RESIDENTS AND NEIGHBORHOODS viii (2000), http://www.huduser.org/publications/PDF/lihtc.pdf [https://perma.cc/5VL8-PP3B]).
191 *Id.*
192 Rachel Bratt, *Affordable Rental Housing Development in the For-Profit Sector: A Case Study of McComrack Baron Salazar* 25 (Harvard Joint Ctr. for Hous. Studies, Working Paper, 2016), http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/bratt_mbs_feb_2016_final.pdf [https://perma.cc/D3TR-G25Q].
193 *Id.*
194 *See id.* at 80.
195 *Id.* at 8.
196 *Id.* at 10.
197 *Id.* at 2.

between 1987 and 2013, for-profit developers produced around 78 percent of LIHTC projects."[199] In addition, from 2009 through 2014, of the top fifty developers, 79 percent of all affordable housing starts were for-profit firms.[200]

A 2014 survey reported that for-profit developers constructed the majority of units produced in 2014.[201] Specifically, of the top fifty-six developers in the survey, for-profit firms started 86 percent of the affordable housing projects and completed 79 percent of the affordable housing projects.[202] Of the fifty largest groups that owned affordable housing units in 2014, thirty-five were for-profits.[203] In addition, each of the top ten firms for acquiring affordable housing units was for-profit,[204] but four nonprofits were included in the top ten firms for substantial rehabilitation work in 2014.[205] This is reflective of the fact that for-profit's have the financial advantage of being less reliant on federal loans and have more sources of ready capital.[206]

In sum, for-profit developers and companies have constructed or rehabilitated a greater number of affordable housing units and received a larger number of LIHTCs than non-profit developers.[207] Despite the LIHTC Program's failure to incentivize the development of affordable housing for the extremely poor, the privatization of affordable housing realized by the Program is

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198 There are certain LIHTC projects that are not part of the calculation given that the HUD site does not provide complete information on those projects.

199 Bratt, *supra* note 192, at 2 n.1.

200 *Id.* at 3.

201 *Top 50 Affordable Housing Developers of 2014*, AFFORDABLE HOUS. FIN. (Apr. 15, 2014), http://www.housingfinance.com/news/top-50-affordable-housing-developers-of-2014_o [https://perma.cc/EUN2-V8C6] [hereinafter *Affordable Housing Finance*]; Bratt, *supra* note 192, at 2.

202 *Top 50 Affordable Housing Developers of 2014,* supra note 201; Bratt, *supra* note 192, at 2.

203 *Affordable Housing Finance,* supra note 201; Bratt, *supra* note 192, at 2.

204 Bratt, *supra* note 192, at 2 ("Together, the ten firms that have completed the most rehabilitated units have produced "7,888 affording housing units.").

205 *Id.*

206 *Id.*

207 *Id.*

generally positive given the number of affordable housing units that have been developed at a low cost to the government.[208]

D. Privatizing Affordable Housing Works

By pushing for the private sector to create affordable housing, the federal government effectively privatized affordable housing. Critics of the privatization of affordable housing find the absence of regulations covering the distribution of LIHTCs amongst for-profit and non-profit entities a failure because it lends support to the notion that the government is not alleviating the burden of those who earn below 50 percent of AMI.[209] On the other hand, proponents of the privatization of affordable housing through the LIHTC Program argue that the availability of new affordable housing for the moderately poor with AMI above 50 percent will lead to "a 'trickle up' response."[210] This argument supposes that as LIHTCs create new housing for the moderately poor, "the moderately poor vacate housing affordable to the very poor," thereby allowing the very poor to move into the moderately poor's old affordable units.[211]

In response to the "trickle up" theory espoused by advocates of the Program, critics claim the results are "illusory."[212] According to the Bipartisan Millennial Housing Commission and as aforementioned, there is still "a critical shortage of affordable apartments for extremely low-income households."[213] Nonetheless, the housing that is built using LIHTCs is "more habitable and sturdy" than the housing that low-income tenants would be residing in otherwise.[214] The Program encourages new construction or complete rehabilitation of existing units, causing low-income renters to gain access to better quality units.

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[208] *See* JOINT CTR. FOR HOUS. STUDIES OF HARVARD UNIV., LONG-TERM LOW INCOME HOUSING TAX CREDIT POLICY QUESTIONS 5–9 (2010), http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/long-term_low_income_housing_tax_credit_policy_questions.pdf [https://perma.cc/DSG7-CTCW] [hereinafter *LIHTC Policy*].
[209] *See* Ballard, *supra* note 1, at 233.
[210] *See id.*
[211] *Id.*
[212] *Id.* at 233–34.
[213] *Id.* at 229 (citing BIPART. MILLENN. HOUS. COMM'N, MEETING OUR NATION'S HOUS. CHALLENGES 12 (2002), http://govinfo.library.unt.edu/mhc/MHCReport.pdf [https://perma.cc/YB9G-69PP]).
[214] *Id.* at 235.

While many ideal policies are created in a theoretical vacuum, the Program has proven to be a cost-efficient and generally feasible government policy that has survived in the current political climate of heightened economic constraints.[215] By incentivizing the private sector to develop affordable housing, the government has increased the supply and quality of affordable housing units.[216] The Program is therefore the best framework to counteract the affordable housing crisis in spite of the fact that it might not be the most efficient policy.[217] Given the problems that persist, the Program, while successful, can certainly be improved to (1) reduce the existing deficit of affordable housing units and (2) incentivize the development of a larger supply of affordable housing.[218]

V. Expanding the Recipients of LIHTCs: The Case for Allowing REITs to Utilize LITCHs

The federal government should create a new formula that expands the eligible recipients of LIHTCs, as this legislative fix could unleash a greater demand amongst investors and developers for the credits and subsequently yield a greater supply of affordable housing.[219] Although developers may be willing to build affordable housing projects, they are not able to find ready capital and reasonable financing terms.[220] To solve this problem, investors and nonprofit members could pool together capital utilizing the REIT to finance "the gap in affordable housing."[221] This, however, would

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[215] *See LIHTC Policy*, supra note 208, at 5.
[216] *See id.* at 6–7.
[217] *Id*. at 28.
[218] *Id*.
[219] Nicolas Retsinas, *REITs and affordable housing a public-private marriage of convenience*, REAL EST. WKLY. (2015), http://rew-online.com/2015/07/16/reits-and-affordable-housing-a-public-private-marriage-of-convenience/ [https://perma.cc/36NM-AW6Q].
[220] Jane Adler, *Developer Scramble to Fill LIHTC Project Funding Gaps*, SENIORS HOUS. BUS. (Jan. 19, 2016), http://www.seniorshousingbusiness.com/from-the-magazine/developers-scramble-to-fill-lihtc-project-funding-gaps [https://perma.cc/9YTF-Y2DD].
[221] Sara Borchersen-Keto, *Minding the Gap in Affordable Housing*, REIT (Dec. 11, 2016), https://www.reit.com/news/reit-magazine/november-december-2016/minding-gap-affordable-housing [https://perma.cc/A7QU-S5CN].

only work if the REIT qualified for LIHTCs.[222] Therefore, if the laws were amended this new formula would merge the benefits of the structure of a REIT with the incentives of the LIHTC program.[223]

A. Overview of REITs

In 1960, Congress amended the Internal Revenue Code to include REIT taxation.[224] As a result, investors in REITs are taxed as if they purchased equity in real estate, real estate, or mortgages.[225] Although REITs are treated like a corporation under tax law, REITs have a deduction for dividends paid to shareholders.[226] This deduction eliminates the double tax, notwithstanding the fact that taxable-REIT shareholders are required to pay tax on the REIT's distributed income.[227] In order for an entity to be able to obtain this tax deduction, an entity must elect to be a REIT, distribute at least 90 percent of its taxable income each year,[228] and comply with the organizational, assets, and income tests."[229]

To satisfy the organizational test, a REIT can be a state-law corporation, trust, or association, [230] and must be managed by one or more trustees or directors. [231] Additionally, "[t]he ownership of a REIT must be evidenced by transferable shares or certificates of beneficial interests, the interests must be held by 100 or more persons, and generally the REIT ownership cannot be highly concentrated in a small number of investors (i.e., closely held)."[232] Finally, a REIT must not be a financial institution or an insurance company.[233]

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[222] Reaman, *supra* note 15.
[223] *Id*.
[224] I.R.C. § 856 (2012); Bradley T. Borden, *Reforming REIT Taxation (Or Not)*, 53 HOUSTON L. REV. 1, 3 n.2 (2015) (stating the amendment was part of the Tax Reform Act of 2014).
[225] §§ 857–58. *See generally* John C. Dawson, Jr., *The Real Estate Investment Trust*, 40 TEX. L. REV. 886 (1962).
[226] Borden, *supra* note 224, at 21.
[227] *Id.* at 21–22.
[228] § 856(a); Borden, *supra* note 224, at 22.
[229] § 856(c); Borden, *supra* note 224, at 22.
[230] § 856(a); Borden, *supra* note 224, at 22.
[231] § 856(a); Dawson, *supra* note 225, at 888.
[232] § 856(a)(5); Borden, *supra* note 224, at 22.
[233] § 856(a); Borden, *supra* note 224, at 23.

To satisfy the asset test, a minimum of 75 percent of a REIT's assets must consist of real estate assets, cash and cash items, and government securities.[234] This includes "real property, interests in real property and mortgages on real property, and shares in other REITs," as well as "stock or debt instruments that do not otherwise come within the definition of real estate assets, but that the REIT holds as a temporary investment of new capital."[235] Also, a REIT must be diversified, and can hold up to 25 percent of nongovernmental securities and up to 25 percent of securities in taxable REIT subsidiaries.[236] Other limitations include a maximum of 5 percent of REITs assets that can be represented by the securities of one issuer, and 10 percent "in vote and value" of the outstanding securities of anyone issuer.[237]

To satisfy the income test, a REIT must comply with both a 75 percent gross income test and a 95 percent gross income test.[238] Both of these tests require that a REIT's income be derived from real property, including rents, mortgage interest, profit from sale, dividends from shares of other REITs, and tax abatements.[239] For the 75 percent test, at least 75 percent of the REIT's value total assets must be represented by real estate assets, cash and cash items, and Government securities.[240] For the 95 percent test, 95 percent of the REITs gross income must be derived from the sources listed above, in addition to dividends, interest, or capital gains on securities.[241] The 75 percent and 95 percent tests ensure that a REIT's income is "mostly from passive sources."[242]

If all the tests are met, the REIT is taxed at ordinary corporate rates with a deduction for dividends distributed.[243] This means that a shareholder of a REIT is taxed at a normal rate on income distributed and at the capital gain rate on capital gains distributed.[244]

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234 § 856(c)(4)(A); Borden, *supra* note 224, at 23.
235 § 856(c)(4); Borden, *supra* note 224, at 23.
236 § 856(c)(4)(A); Borden, *supra* note 224, at 24.
237 Borden, *supra* note 224, at 24.
238 § 856(c)(3); Borden, *supra* note 224, at 25.
239 Borden, *supra* note 224, at 25.
240 § 856(c)(4)(A).
241 § 856(c)(2); Borden, *supra* note 224, at 25.
242 Borden, *supra* note 224, at 25.
243 Dawson, *supra* note 225, at 890.
244 *Id.*

Ultimately, the REIT structure offers investors the benefits of a diversified investment, expert investment counsel, and the ability to collectively finance.[245] Before this change, only the wealthiest persons, insurance companies, and union funds could make investments in income-producing real estate.[246] From a tax perspective, REITs enabled small investors to receive the same benefits as large investors by pooling their resources.[247] Congress permitted these entities to raise capital, in order to finance and promote real estate projects that would, in turn, stimulate the economy.[248] Since the original 1960 amendment adding REITs to the tax code, Congress has permitted institutional investors to own all of a REIT's stock, lowered REITs' distribution obligations, and allowed REITs to provide more services.[249]

B. A Formula for More Affordable Housing: Permit REITs to Use LIHTCs

1. Non-Profit Forms REIT to Purchase Affordable Housing

The rules and regulations that apply to REITs have changed according to the demands of the real estate industry, economy, and societal benefit.[250] Recently, a nonprofit group, Mercy Housing, Inc. (Mercy), formed a REIT and subsequently developed affordable housing units.[251] This situation demonstrates that a significant opportunity exists for REITs to become more involved in building affordable housing units, especially where REITs are permitted to pass along the benefits of LIHTCs to investors.[252] Currently, it is disadvantageous for REITs to build affordable units because the

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[245] *Id.* at 886.
[246] *Id.*
[247] *Id.* at 887.
[248] *Id.*
[249] Borden, *supra* note 224, at 28; *see* I.R.C. §§ 856–58 (2012).
[250] Mith Irzinski, *How Do REITs Work*, REIT (Jan. 1, 2014), https://www.reit.com/news/videos/how-do-reits-work [https://perma.cc/8RHG-9YQD].
[251] A.D. Pruitt & Dawn Wotapka, *Saving Affordable Housing*, WALL ST. J. (Apr. 20, 2013), http://www.wsj.com/articles/SB10001424127887323798104578455061791601352 [https://perma.cc/6K4Z-5E9E].
[252] *See id.*

REITs would be effectively forfeiting LIHTCs since REITs are not flow-through entities that can pass the LIHTCs through to investors.[253] Thus, if REITs qualify as recipients of the tax credits, both for-profits and non-profits can use the REIT structure to develop affordable housing and spur demand for LIHTCs.[254]

In 2013, Mercy, in a joint venture with a private REIT created by Mercy and eleven housing-related non-profits, paid over $5 million for an affordable housing complex in Chicago.[255] This deal was the first acquisition of an affordable housing project "made by a real-estate company owned and operated by nonprofits."[256] This case typifies how companies or "organizations with a social mission can utilize the for-profit structure to advance their goals."[257] Since for-profit developers are absorbing many of the units and have ready access to capital, non-profits have faced great difficulty in completing their mission.[258] Thus, as this Chicago-based deal demonstrates, non-profits and housing proponents can "combin[e] the benefits of their nonprofit structure with the financial flexibility that comes from operating a REIT."[259]

In this example, the REIT structure enabled Mercy to purchase the property because the REIT gave it the advantage of having a large pool of accessible capital, as opposed to having to apply and wait for federal or state grants.[260] This deal, between a REIT and joint venture, is one way in which REITs can invest in affordable housing and provide affordable housing to extremely low-income persons with AMI below fifty percent and allow nonprofits to remain competitive in constructing affordable housing.[261]

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253 Reaman, *supra* note 15.
254 *See Id.*
255 Pruitt &Wotapka, *supra* note 251.
256 *Id.*
257 *Id.*
258 *Id.* ("Housing advocates have been alarmed by the rapid decline in the supply of affordable housing, the result of landlord's scooping up low-income properties and converting them into luxury dwellings. . . . The increased activity of for-profits has made it difficult for nonprofits to remain active buyers; they can't pay the high price tags or move quickly.").
259 *Id.*
260 *Id.*
261 *See id.*

2. White House Policy Recommendations

Investors are attracted to REITs because of their single level tax structure.[262] In the President's fiscal year 2014 budget, the White House proposed modifying REIT rules "to promote tax credit deals by allowing REIT shareholders to benefit from the [LIHTC]."[263] Tax credits do not pass through REITs to shareholders because REITs are not flow through entities.[264] This means that to the extent that credits distribute taxable income, shareholders of REITs cannot claim the credits because dividends from LIHTCs are not listed as a tax exemption in the tax law.[265]

The Treasury Department expanded on the President's budgetary proposal by highlighting that LIHTCs would be even more effective if there was a greater demand for such credits.[266] Given that the subprime mortgage crisis and subsequent recession saw a decline in investments per dollar of LIHTC acquired, the Treasury Department found that "[i]f REIT shareholders could benefit from any LIHTCs that REITs receive, there would be an increase in demand."[267]

The White House's proposal specifically modifies the structure of REITs, by stating that an REIT awarded LIHTCs is able to "designate as tax exempt some of the dividends that it distributes," which the REIT's shareholders could then exclude from their gross income.[268] The amount of the REIT's dividends would not be allowed to exceed the amount of the REIT's LIHTCs for that year, divided by the highest corporate tax rate.[269] In short, the proposal permits "a REIT that earns LIHTCs to provide a tax benefit to its investors by paying them tax-exempt dividends in an amount almost triple the amount of the REIT's LIHTCs."[270] Ultimately, affordable

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[262] Reaman, *supra* note 15.
[263] *Id.*
[264] I.R.C. § 857(b) (2012); Reaman, *supra* note 15.
[265] *See* § 857(b)(2); Reaman, *supra* note 15.
[266] Reaman, *supra* note 15.
[267] *Id.*
[268] *Id.*
[269] *Id.*
[270] U.S. DEP'T OF HOUS. & URBAN DEV., FISCAL YEAR 2013 PROGRAM AND BUDGET INITIATIVES LOW INCOME HOUSING TAX CREDITS (Mar. 2012), http://portal.hud.gov/hudportal/documents/huddoc?id=FY13BudFSLIHTC.pdf [https://perma.cc/QL67-SBUZ].

housing REITs are vehicles by which capital can flow more freely to the developers willing to build housing for low-income people and more affordable housing.[271] Because "REITs harness the engine of America's private enterprise," REITs can drive construction not only in the office and residential sectors, but in low-income housing as well.[272]

V. Conclusion

The government's role in the affordable housing crisis has shifted from being a housing provider to promoter over the last several decades. Early policies called for the government to build and maintain public housing and offer direct subsidies to low income persons. President Reagan upended this tradition of government subsidized housing when he signed into law the Tax Reform Act of 1986, which created LIHTCs. The creation of LIHTCs acted as a catalyst by incentivizing the private sector to play a greater role in producing affordable housing options for the public.

LIHTC supporters point to low foreclosure rates, good compliance history, positive credit allocating agency review experience, minimal fifteen-year opt-outs, and strong investor portfolio analysis as proof of the LIHTC Program success. Meanwhile, its critics point to the fact that the Program has not been successful in providing affordable housing options to persons who are extremely poor. Critics argue that non-profits are typically forced to fill in this gap, but face capital constraints since they do not have the same financing options readily available as their for-profit counterparts. On balance, however, this Program has successfully reacted to the affordable housing crisis by increasing the overall supply of affordable housing.

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[271] *See* Nicolas Retsina, *REITs and affordable housing a public-private marriage of convenience*, REAL EST. WKLY. (July 16, 2015), http://rew-online.com/2015/07/16/reits-and-affordable-housing-a-public-private-marriage-of-convenience/ [https://perma.cc/8Y8C-THGA] ("Federal tax incentives make investing in affordable housing an opportunity for safe risk-adjusted returns. . . . [D]evelopers are willing to build and rehabilitate affordable housing, but many lack sufficient capital to make a major contribution to the inventory and address the dire shortage. . . . Affordable housing REITs are a bridge to the capital desperately needed to house low-income Americans.").

[272] *Id.*

In recognizing the areas where this Program can be improved, this note identifies a policy proposal that could expand the reach of LIHTCs by solving some of the problems critics point to. Specifically, this note recommends modifying tax laws involving REITs to facilitate a greater demand for these tax credits by for-profit and non-profit REITs.

The increased demand of the credits would result in the credits' increase in worth and desirability to investors. As a result, this would lead to a greater number entities applying for the LIHTCs and building affordable housing. By offering REIT shareholders the benefits of the tax credits, REITs would increase their involvement in affordable housing and finance developers building such housing. This would also enable non-profits to pool together capital through the REIT structure and compete with their for-profit counterparts for LIHTCs. If a greater number of non-profit entities using the REIT structure were awarded the credits then these entities could more easily build affordable housing options for the extremely poor. This would mollify critics' main critique of the Program, and more importantly, help solve the affordable housing crisis. Besides assisting the extremely poor, this change would yield an overall greater demand for LIHTCs and lead to an overall greater supply of affordable housing.

In sum, this note calls for Congress to amend the law to permit REITs to absorb the benefits of LIHTCs.[273] By merging the public's need for more affordable housing with the profit driven interests of the private sector, this legislative change would expand on the success of the LIHTC Program and create a new formula for a greater supply of affordable housing. Ultimately, this policy change is politically tenable for Congress because it creates a new formula for a greater supply of affordable housing at the expense and interest of the private sector, and more importantly, at little direct cost to the federal government.

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[273] *See* U.S. DEP'T OF THE TREASURY, GENERAL EXPLANATIONS OF THE ADMINISTRATION'S FISCAL YEAR 2015 REVENUE PROPOSALS 38 (2014), https://www.treasury.gov/resource-center/tax-policy/Documents/ General-Explanations-FY2015.pdf [https://perma.cc/TUU7-F2CR].