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Uncertainty Over Tax Reform Is Already Hurting Affordable Housing

Awaiting action from Congress, investors are hitting the pause button on developments that use tax credits to create affordable housing.

KRISTON CAPPS | @kristoncapps | Jan 27, 2017 | 1 Comment

House Speaker Paul Ryan (R-Wisconsin) and Senate Majority Leader Mitch McConnell (R-Kentucky) field questions during a news conference at the GOP congressional retreat in Philadelphia on January 26. (Matt Rourke/AP)

Tax reform will come quickly under the 115th Congress. The next steps lawmakers take will have a profound effect on the affordable housing crisis. By the time legislators break for recess in August, they may have significantly reshaped, and possibly scaled back, the hundreds of billions of dollars in housing aid and tax relief authorized by the federal government.

The housing market isn't waiting for a sign from Congress about what action Republicans will take in revamping the tax code. Anticipating lower corporate tax rates, some investors are already limiting their investments in the Low Income Housing Tax Credit, the federal government's primary instrument for creating new affordable housing in the U.S.

"We're hearing from developers around the country that investors have either slowed or in some cases stopped investing in housing credits while they wait to see what happens with corporate tax reform," says Diane Yentel, president and CEO of the National Low Income Housing Coalition.

Since 1986, developers have used LIHTCs to build millions of affordable-housing units. Banks invest in affordable housing developments by buying the housing credits and claiming various tax-liability benefits over a 10-year return period. Normally, everybody wins. But with future corporate tax rates uncertain, investors are hitting the pause button on LIHTCs while Congress prepares to enact comprehensive tax reform for the first time in 30 years.

"When you start talking about lowering corporate tax rates, investors start to look at it and say, 'Let's wait a minute then,'" says David Gasson, vice president at Boston Capital and executive director of the Housing Advisory Group.

House Republicans have proposed to slash the current corporate tax rate of 35 percent to 20 percent. President Trump has pledged to go as low as 15 percent. For investors, buying tax credits now would represent a loss if and when the corporate tax rate falls.

For investors, buying tax credits now would represent a loss in savings if and when the corporate tax rate falls.

Here's how LIHTCs work: States allocate LIHTCs to affordable housing developers. Investors bid on those tax credits, and in return for their investments, reap tax benefits over the course of 10 years.

In general, tax credits are more attractive than tax deductions because tax credits offer a one-to-one, dollar-for-dollar deduction in federal income tax, whereas deductions only reduce taxable income. Investing in LIHTCs can help a bank meet its obligations under the Community Reinvestment Act, another plus. And with LIHTCs, investors also receive tax losses based on their investments in real property. All good things.

That dollar-for-dollar reduction doesn't change with the tax rate. But the tax losses that investors receive—generally about 30 percent of a housing credit's value—*do* change with the rate. A bank that bought (say) 10 million tax credits at $1 per credit (a $10 million investment) in an affordable-housing investment before the election should expect the value of its tax benefits to shrink after Congress lowers the corporate tax rate. That's right: Every bank that closed on an affordable housing development through LIHTCs over the last nine or so years before the November 8, 2016, election is now likely looking at a write-down.

"Each subsequent year, the investor is not going to be able to claim as much against their taxes as they were planning," says Peter Lawrence, director of public policy and government relations at Novogradac, an accounting and consulting firm that specializes in real estate and affordable housing projects.

Obviously, investors want to limit their future losses on affordable housing developments that are near to closing. Some are taking a wait-and-see approach, Lawrence says, while others are negotiating special language with developers to underwrite an investment with a lower rate in mind. Uncertainty is gumming up the works—leaving developers in the lurch.

That's not to say that investors have lost their appetite entirely for housing tax credits, the way they did in 2008–2009, the last significant disruption in the LIHTC equity market, Lawrence says. Along with Mark Shelburne, senior manager for public policy at Novogradac, Lawrence is tracking responses from the state agencies that allocate LIHTCs to the disruption.

"Here we are in a situation where many investors are still very much interested in LIHTC investment, but they simply don't know how to value them because of uncertainty over the corporate tax rate," he says. "I wouldn't be surprised if we continue to have uncertainty and volatility until it's clear that tax reform in some form is happening or until Congress abandons the effort."

It remains to be seen exactly how much less affordable housing will be built as a result of development deals that stalled out at the last minute. Investment in the program is still higher than it was seven to 10 years ago, Shelburne says. And every investor they have talked to still anticipates having a substantial tax liability and an interest in credits, Lawrence adds. Moreover, tax reform could take longer than Republicans in Congress anticipate.

"It is still troubling for a lot of developers," Lawrence says. "It causes problems for developers who need to close their deals soon."

While the federal government has a number of programs designed to help low-income families find housing, LIHTCs are the only proven entity in creating new affordable housing. According to Harvard University's Joint Center for Housing Studies, LIHTCs have supported the construction of some 2.8 million rental units since 1986. No other federal program comes close. For example, the new National Housing Trust Fund, which is designed to expand housing for the very poorest households, is modest; the 2016 allocation was $173 million, about $3 million per state.

Local initiatives also can't hold a candle to housing credits. Although a growing number of communities have adopted inclusionary housing policies—zoning mandates that set aside affordable units in market-rate developments—the number of affordable units created by zoning policies is small. Inclusionary policies are responsible for a total of 129,000 to 150,000 affordable units altogether from 1970 through 2010, according to the Lincoln Institute of Land Policy.

> **The shortage of affordable rental units, especially for the very poorest households, is severe.**

The U.S. can scarcely afford an affordable housing slowdown. The shortage of affordable rental units, especially for the very poorest households, is severe. The National Low Income Housing Coalition estimates that the nation faces an absolute shortage of 4.6 million units affordable to extremely low-income households (those making 30 percent of area median income or below). This figure is exacerbated by the fact that about half of the existing units that are affordable for these households are occupied by people with higher incomes, meaning the true gap is more than 7.2 million affordable units.

No program truly serves the most vulnerable households, not even LIHTC. Where they are able, they rely on subsidies provided through Housing Choice Vouchers, Section 8, public housing, and other rental-assistance programs. But these discretionary-spending programs have declined over the past 40 years and suffered since 2011 as a result of the sequester. And now that the Republican Party controls all branches of government, Congress could turn federal housing-assistance programs into block grants (one of House Speaker Paul Ryan's dreams) or eliminate this kind of spending altogether. If aid for struggling families takes a hit, then more households may fall into deeper poverty as a result.

Housing tax credits can't save these vulnerable households. But the LIHTC program is keeping a more severe crisis at bay. And unlike social safety-net programs such as Section 8, the LITHC program enjoys strong bipartisan support in Congress, housing advocates say. Since it's also popular in the housing market—applications vastly outnumber credits—it's unlikely to be culled as part of tax reform.

"A number of members on the Republican side of the [House Ways and Means Committee] have been very supportive and understand the significance of this program. Same thing on the Finance Committee," Gasson says. "When we get a member out to see an affordable housing property in their district, we have a 100 percent success rate in them supporting the LIHTC program."

Tax reform may nevertheless work at cross purposes with housing credits: If corporate tax rates are slashed too sharply, housing credits won't provide the same incentive to investors. The LIHTC program may not generate more housing in the future than it does today. With housing assistance on the chopping block, the need for housing is only going to grow. Congress will need to take action to preserve and expand the efficacy of the one program that generates new affordable housing units if the nation is going to weather this affordability crisis.

"We're not even scratching the surface," Gasson says. "We have shown members of Congress the significance of this program and the need for it. They get it. They totally get the program."

About the Author

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