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The Low-Income Housing Tax Credit: Policy Issues

The low-income housing tax credit (LIHTC) program is the federal government's primary policy tool for the development of affordable rental housing. The program awards developers federal tax credits to offset the cost of producing affordable rental housing for low-income tenants. The program, which was created by the Tax Reform Act of 1986 (P.L. 99-514), is estimated to cost the government an average of approximately $9.9 billion annually. Proposals in the 116th Congress would modify the LIHTC program, some of which would expand the program and increase its cost.

This In Focus provides a brief overview of the LIHTC program and discusses select policy issues. For more detailed information on the program, please see CRS Report RS22389, *An Introduction to the Low-Income Housing Tax Credit*, by Mark P. Keightley.

Overview of the Program

LIHTCs are federal tax credits awarded to developers to offset construction costs in exchange for agreeing to reserve a fraction of rent-restricted units for lower-income households. The tax credits are claimed over a 10-year period. Because developers need upfront financing to complete construction, they typically sell the 10-year stream of tax credits to outside investors (e.g., corporations, financial institutions) in exchange for equity financing.

Investors require a return in exchange for providing capital, which diverts a portion of each tax credit away from subsidizing construction costs. An investor, for example, may agree to contribute $0.90 in equity financing per $1.00 tax credit they receive. This would mean that $0.10 of the tax credit did not go toward subsidizing construction costs. The complexity of these transactions may also require overhead costs (e.g., lawyers, accountants, and syndicators) exceeding those incurred in developing market-rate housing, further reducing the effective subsidy.

Outside investors and others play an important role in evaluating the quality of proposed projects, as well as providing oversight and compliance monitoring after construction is complete. Effectively, the LIHTC mechanism outsources a portion of the oversight and compliance monitoring to investors in exchange for a financial return. The reduced oversight and compliance burden may be valuable to the federal government, but it is an unresolved empirical question whether the return earned by investors and others is justified by the service they provide.

The LIHTC is a provision of the tax code and is therefore under the oversight of the Internal Revenue Service (IRS). The primary administrators of the LIHTC program, however, are state and local housing finance agencies (HFAs). HFAs screen applications to determine which developers receive an award of credits. Delegating this authority to HFAs gives each state the flexibility to address its individual housing needs, which is important given the local nature of housing markets. It also reduces the federal government's oversight role since HFAs are also charged with containing costs and monitoring projects to ensure they are compliant with the program rules.

The federal government's principal housing agency, the Department of Housing and Urban Development (HUD), has no direct oversight of the program unless other HUD subsidies are involved. HUD is involved in some indirect aspects of the program's administration since it determines area median income (AMI), which governs who can reside in an LIHTC property, and what rent may be charged. HUD also designates Difficult Development Areas (DDAs) and Qualified Census Tracts (QCTs), which are used to determine if an LIHTC property qualifies for extra tax credits. Additionally, HUD maintains some data on the program.

Selected Policy Issues Facing Congress

Affordable Housing Supply

Since 1987, the LIHTC program has created just over 3 million affordable rental units. An important question when evaluating the success of the program is whether these 3 million units have expanded the net affordable housing supply, or whether they have replaced ("crowded out") affordable housing the private market would have otherwise provided as existing units aged, existing properties were offered for rent, and developers increased the supply of housing more generally.

Economic theory predicts that researchers should find varying degrees of crowding out given the unique features of each housing market, particularly each one's ability to accommodate additional construction. The empirical research indicates that not all LIHTC construction can be considered net additions to the affordable housing stock. The findings range from little crowding out to nearly 100%, and depend on the market examined, the data used, and the methodological approach of the researchers.

Quality of Housing

Another important component in evaluating the success of the LIHTC program is whether it increases quality of the affordable housing supply. Given that LIHTC construction involves either new units or significantly rehabilitated units, it is likely that LIHTC results initially in higher-quality housing along at least one dimension: physical features and amenities. Rent controls, though, like those present in the LIHTC program, may affect the ability and incentive to maintain the physical quality over time.

The neighborhood a property is located in may be considered another aspect of housing quality. A property located in a neighborhood with low crime and access to public resources and services, good schools, and proximity to employment—a high-opportunity neighborhood—can be considered of higher quality than a property located in an area lacking these opportunities. Research tends to indicate that the LIHTC program has not been particularly successful in providing housing in high-opportunity neighborhoods, and that LIHTC units are often located in neighborhoods with less opportunity than other rental units. The one exception is that LIHTC units may be located in neighborhoods with better transit access.

Production versus Tenant Subsidies

Traditionally, economists have generally questioned the cost effectiveness of housing production subsidies like LIHTC. The skepticism is partly because production subsidies incentivize constructing new properties (or substantially rehabilitating existing ones), which is an expensive way to provide shelter. An alternative argument is that affordability can be increased more cost effectively by subsidizing tenants' incomes—for example, by providing individuals with a rental voucher. Individuals, in turn, are able to secure housing from currently available properties or ones that become available in response to the demand for housing at higher rents, which is a cheaper way to provide shelter than constructing new buildings.

A few recent studies examined the cost effectiveness of production versus tenant housing subsidies. They typically have found tenant subsidies to be more cost effective, but the degree to which this is true depends on the specific market. Additionally, construction subsidies may be cost effective in certain instances. For example, subsidizing the construction of housing for groups with special needs may be most cost effective because locating these individuals together makes it easier and less expensive to provide supportive services. In the end, affordable housing policy would benefit from a comprehensive analysis of the cost effectiveness of the two approaches.

Amount of Subsidization

The LIHTC program subsidizes up to 30% or 70% of eligible costs, depending on whether tax-exempt bond financing is also used. These subsidy rates can increase up to 39% and 91%, respectively, for construction in a DDA or QCT. Little research has attempted to determine if these LIHTC subsidy rates are appropriate. Part of the difficulty in studying this issue is isolating the effect of the LIHTC from multiple other layers of subsidization. In addition to tax-exempt bond financing, developers may also rely on the federal historic rehabilitation tax credit, HOME Investment Partnerships Program (HOME) grants, Community Development Block Grant (CDBG) funds, National Housing Trust Fund assistance, the U.S. Department of Agriculture (USDA) Section 515 Rural Rental Housing Loan program, as well as state tax incentives and financial assistance. Additionally, tenants may also be receiving rental assistance such as Section 8 vouchers.

Oversight

As previously discussed, the administration of the LIHTC program has been primarily delegated to HFAs, although the IRS is the federal agency responsible for overseeing the program. By design, investors and other interested parties share in oversight and monitoring. If additional government subsidies are involved, then properties may be subject to monitoring requirements under the rules of those programs.

LIHTC properties experience extremely low rates of foreclosure, and investors are rarely required to forfeit or repay tax credits due to compliance violations. This fact is often referenced by program advocates in asserting that investors and HFAs provide useful oversight of the program. However, investor oversight ends 15 years after a property is awarded tax credits because investors are no longer under the threat of losing or repaying credits. HFAs also require developers to submit audited cost statements, but as is true in other industries, occasionally fraud may occur.

With respect to federal oversight, a 2015 Government Accountability Office (GAO) study found that the IRS provided very little oversight of the program. GAO determined that the IRS has conducted only seven audits of state and local HFAs since 1986. GAO attributed part of the lack of oversight to the fact that the IRS is not a housing agency and does not view the program as being in line with its primary mission or use of resources. GAO recommended that Congress designate HUD as a joint administrator of the program.

Data Availability and Collection

The IRS collects and reports little data on the LIHTC program. In comments made in response to a 2018 GAO report, the IRS stated that its statutory authority to collect data on the program is limited and that it "collects data only to the extent necessary for tax administration." The IRS also mentioned that tax administration does not involve evaluating tax provisions that serve a nontax purpose.

HUD voluntarily publishes LIHTC project-level data and was mandated by the Housing and Economic Recovery Act of 2008 (HERA; P.L. 110-289) to report information on specific tenant characteristics. HERA authorized $6.1 million to assist HUD in collecting tenants' data, but the funding was never appropriated. Providing this funding would likely assist HUD in satisfying its mandate and improving on its already valuable data.

Data not currently collected that would be useful in studying the program include information on construction and land costs; fees paid to developers, syndicators, and other parties involved; prices paid for tax credits; operating revenues and expenses; other noncredit claims investors receive; and a complete picture of financing sources, including other federal and state subsidies, among other data items. Data that tracked the outcomes of properties and tenants over time would also be useful.

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