THE PUSH FOR TAX CREDIT REFORM

WHERE STATES ARE FALLING SHORT

BRAD VOGELSMEIER
MASTER OF URBAN PLANNING, 2015

The Low-Income Housing Tax Credit Program has been a popular tool for providing affordable housing in the United States over the past 30 years. Despite its popularity, many scholars and political leaders scrutinize the program for its role in exacerbating social issues, such as poverty concentration and racial segregation in urban areas. This article explores the role that each state's Qualified Allocation Plan (QAP) plays in distributing these low-income housing tax credits to developers and the ways in which the QAP may contribute to these social issues. Specifically, the article looks at the state of Missouri and the City of St. Louis as an example of where the autonomy granted to states to oversee credit allocation may work against the overall intentions of the LIHTC program and where potential reform could be successful.

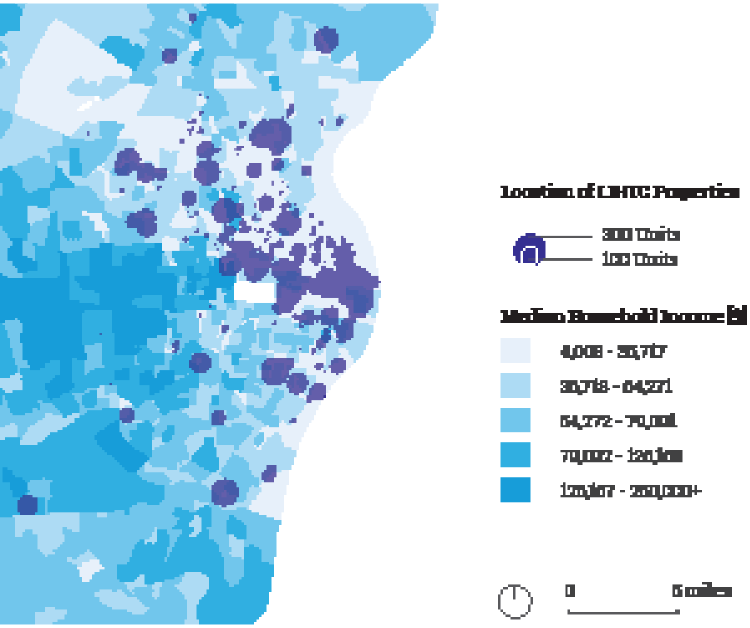
Established by the Tax Reform Act of 1986, the Low-Income Housing Tax Credit (LIHTC) program has had a prominent role in delivering affordable rental housing in the United States. This federal program has successfully encouraged private developers to invest in affordable housing by using tax credits as an alternative source of project equity (MHDC, 2007). Since 1986, the LIHTC program has helped finance more than 2.4 million affordable housing units for low-income households and is now the largest federal housing production program in the United States (Black, 2014). Even though the supply of public housing continues to decline, the tax credit program continues to grow by about 90,000 units per year (Schwartz, 2008). Several states have made their own individual efforts to expand this production program and, as of 2014, sixteen states had enacted their own low-income housing tax credit programs, which supplement the federal tax credits.

Despite impressive housing production numbers, this program does not fully address low-income housing issues, such as poverty concentration, racial segregation, and crime (Johnson, 2014). While several studies show that the LIHTC program has done a better job of deconcentrating poverty than other federal policy programs, more still needs to change (Johnson, 2014). A major cause for concern is the way in which Qualified Allocation Plans (QAP) influence the location of individual projects and whether or not their structure and format heightens some of the aforementioned issues. Broadly, this article explores the credit allocation process and the role of the Qualified Allocation Plan in determining the location of LIHTC developments. More specifically, it looks at the state of Missouri and the City of St. Louis as examples of why the autonomy granted to states to oversee credit allocation may work against the overall intentions of the LIHTC program.

THE QUALIFIED ALLOCATION PLAN

The Internal Revenue Service (IRS) is the governing body responsible for allocating tax credits to individual states based on their population (Shah, 2014). Since its inception, the popularity of the program has caused project applications to exceed the number of available credits. Because of this, individual states play a large role in determining the merit of proposed LIHTC developments. Section 42 of the Internal Revenue Code, the law that governs the LIHTC program, requires the state agency responsible for allocating the tax credits to create an annual QAP, which sets the criteria for project selection. The IRS considers QAPs qualified only if they follow procedural protocol, report situations of noncompliance, and allow for public comment when drafted annually (IRS, 2014). States can set individual priorities and selection criteria within the QAP, but Section 42 sets preferences for projects "serving the lowest income tenants," "serving income-eligible residents for the longest period of time," and located in federally designated priority areas as long as the project follows a concerted community revitalization plan (Gramlich, 2013, pg. 1). These "preferences," as dictated by the IRS, extend as far as mandating that selection criteria include projection location, housing need characteristics, sponsor characteristics, public housing waiting lists, individuals with children, special needs populations, existing area housing, projects intended for eventual tenant ownership, energy efficiency, and historic nature (Gramlich, 2013).

Aside from these minimum requirements, states have the autonomy to decide how to define and measure these preferences, how or if to rank them, and whether or not to relate them to other state priorities. Selection criteria are often heavily based on the staff's opinions and knowledge of housing trends and on selection committee



Map 1

LIHTC Properties in St. Louis. Dots are sized in proportion to the number of housing units in each development. Sources: ACS (2008-2013); HUD, 2015.

members' priorities (Shimburg Center for Affordable Housing, 2001). In a 2001 study of state allocation policies, different states used a number of sources to determine selection criteria, but all states surveyed used staff and board opinion (Shimburg Center for Affordable Housing, 2001). By comparison, only ten of 20 states used an advisory committee or public comment process to determine QAP priorities (Shimburg Center for Affordable Housing, 2001). Other sources of information can include state statutes, research and analysis, consolidated plans, and other state agencies. Such board discretion contributes to the uniqueness and complexity of each state's QAP.

Policy-related selection criteria also play a large role in tailoring an individual state's allocation plan. Common criteria such as family size, geographic location, local planning priorities, income targeting, and special needs are used to identify the best possible LIHTC opportunities. Even though Section 42 requires that states include many of these criteria in the selection process, the degree to which they prioritize them is influenced by what officials consider relevant to state-level needs. For example, several states prioritize projects in economically distressed areas, which are variously defined as areas with ten percent or more of households in poverty, or in what the Department of Housing and Urban Development (HUD) defines as Difficult Development Areas (DDA) or Qualified Census Tracts (QCT) (Shimburg Center for Affordable Housing, 2001). In order to qualify as a DDA, a location must have high construction, land, and utility costs relative to gross median income; to be considered a QCT, an area must have a poverty rate of at least 25 percent (Black, 2014).

Private developers also play a large lobbying role in determining and deciphering the incentives within the QAP. In states with well-defined point systems, many developers will position their projects to score as many "marginal" points as possible. This is because essentially every project applying for credits will receive them, since many point categories act as thresholds or must-have points (Black, 2014). The marginal points then become the most contested because they often influence where developers choose to acquire property for LIHTC use or which properties they already own and will attempt to take the LIHTC and turn into income- and rent-restricted housing (Khadduri, 2013). This process of chasing points reemerges every year during the QAP approval process. Developers use the annual public process to comment extensively on changes that they want made to the QAP, and thus lobby for particular projects and to make other types of projects more fundable (Khadduri, 2013). Through this process the QAP plays a pivotal role in deciding where developers choose to pursue projects.

CREATING LOCATIONAL BALANCE

The QAP needs to create a better balance among the location of LIHTC projects in order to provide low-income individuals with better access to quality-of-life amenities and to uphold the program's mission of advancing fair housing practices in the United States. Authors Cummings and DiPasquale found that the LIHTC program is most frequently used to provide additional rental housing opportunities in already-poor neighborhoods rather than generating affordable units in higher-income areas (Burge, 2011). If anything, current development is actually redirecting low-income units that private companies would otherwise develop in higher-income areas. Study findings suggest that this type of development does little, if anything, to improve neighborhood quality in the already-poor neighborhoods (Burge, 2011).

State agencies need to incentivize developers to locate projects in "high-opportunity" areas rather than areas or neighborhoods with high rates of poverty (Bray, 2011). Currently, developers may not approach high-opportunity areas because they simply cannot meet the threshold requirements in the QAP due to factors such as high land and per-unit development cost. Reform, then, would mean changing the framework by transferring some of the 30 percent additional tax credits, also known as a basis boost, currently awarded to Qualified Census Tracts and Difficult Development Areas, to high-opportunity locations.

Typically, high-opportunity areas are geographic areas that are served by high-quality schools and have access to quality transportation, jobs, superior health care, public services, and other amenities (Bray, 2011). These areas traditionally have less existing poverty than the traditional Qualified Census Tract, which means the choice-based housing voucher program, another housing subsidy program, in these areas may also not be strong. This presents an opportunity for LIHTC projects to locate in neighborhoods where fewer residents use housing vouchers, but rather most of them pay high fair market rents because landlords prefer unsubsidized tenants (Khadduri, 2013). Each state agency also holds a legal responsibility to create locational balance among their housing developments. Because the LIHTC program is subject to the fair housing law, locational balance in LIHTC development falls firmly within the state's obligation to "positively further fair housing" (Khadduri, 2013). This is not to say that current QAP selection criteria directly violate fair housing law, but rather that an opportunity exists to provide more integrated housing options, which is a direct objective stated in the Fair Housing Act (Khadduri, 2013).

Since 1986, the LIHTC has helped finance more than 2.4 million affordable housing units for low-income households and is now the largest federal housing production program in the United States.

Clearly, the QAP is a powerful tool. To better understand how one works in practice and the methods with which individual state QAPs are tailored, we turn to the State of Missouri's QAP and, more holistically, its LIHTC program to understand the effects of credit allocation decisions, as well as the opportunities for reform within the tax credit system in general.

HISTORY OF PUBLIC HOUSING IN MISSOURI

Missouri has been at the center of national discussions on public housing for both its historical ties to Pruitt-Igoe, a famed and failed public housing complex in north St. Louis, and more recent events in Ferguson, Missouri. History has largely dictated where the state now stands in its strategies for addressing issues of poverty concentration, racial segregation, and affordable housing.

The implementation of the Housing Act of 1949 marked the beginning of significant disinvestment in large metropolitan areas during the postwar era. Missouri offered incentives for urban renewal projects, subsidies for industry, and incentives for residents to move to the suburbs, which had a particularly large impact in cities like Kansas City and St. Louis. Both cities saw enormous population decline after World War II; St. Louis City lost an incredible 63 percent of its total population between 1950 and 2010, and Kansas City lost 6.7 percent of its population over the same time period despite growing in size geographically (US Census, 2010). In an effort to lure the middle class back to the central city, city leaders proposed public housing projects like Pruitt-Igoe as a way to limit slum expansion and save the economic health of downtown real estate (Bristol, 1991). The result of this planning strategy was a federal commitment for 5,800 public housing units in St. Louis City, about 2,700 of which were earmarked for Pruitt-Igoe's 57-acre site on the north side, a predominately black ghetto. Federal money was put toward the construction of these projects, but tenants' rents were expected to supplement the maintenance fees. However, as vacancy rates increased in the first two decades, a vicious cycle of disinvestment began. The project's eventual demolition in 1972 serves as powerful image of public housing failure in the United States.

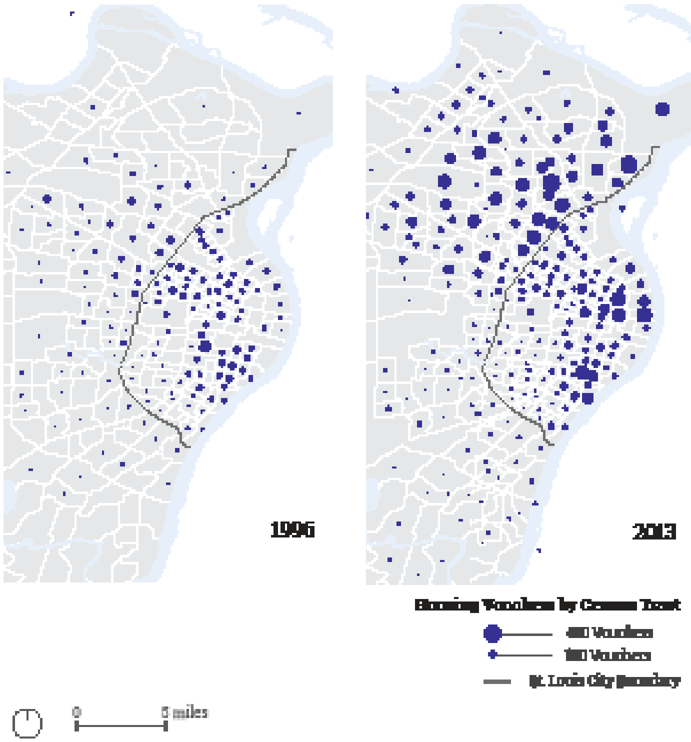
As one era ended, another began with the U.S. government's launch of new affordable housing policies such as Section 8, a tenant-based program that allowed low-income individuals to use vouchers and live where they prefer. Although ideally low-income individuals use vouchers to diversify income levels in communities, in many cases they have difficulty using them in high-rent areas because the subsidies are capped at a percentage of fair market rent. Capped subsidies during the height of Project Based Section 8 housing resulted in pockets of low-income housing clusters in major metropolitan regions across the state (Kansas City, St. Louis). Data from HUD shows that the number of Section 8 voucher recipients in St. Louis County has doubled since the mid-1990s and that close to five percent of the city's total population lives in subsidized housing units (Bogan, 2014).

THE MISSOURI STATE LOW-INCOME HOUSING TAX CREDIT

More recently, the state has supported LIHTC development as the main method of providing affordable housing. Since the program began in 1986, credits have funded the creation of 52,000 housing units in the state of Missouri (Clarke, 2014). In 1992, increased demand for affordable housing led to the Missouri Low-Income Housing Tax Credit, established under Sections 135.350 to 135.363 of the Missouri Revised Statutes (MHDC, 2007). This credit was originally set at 20 percent of the federal credit, but was expanded to 40 percent in 1993; as of 1997, the state credit matches the federal LIHTC on a dollar-for-dollar basis (Young, 2014). The result has been a significant increase in affordable housing production. The state estimates that $9.60 of economic activity is generated per state credit awarded. Despite the program's accomplishment of creating over 50,000 housing units, the state tax credit system has been heavily criticized by the public and the government officials due to its inefficient spending, lack of transparency in project selection, and contributions to creating pockets of immense poverty (MHDC, 2007).

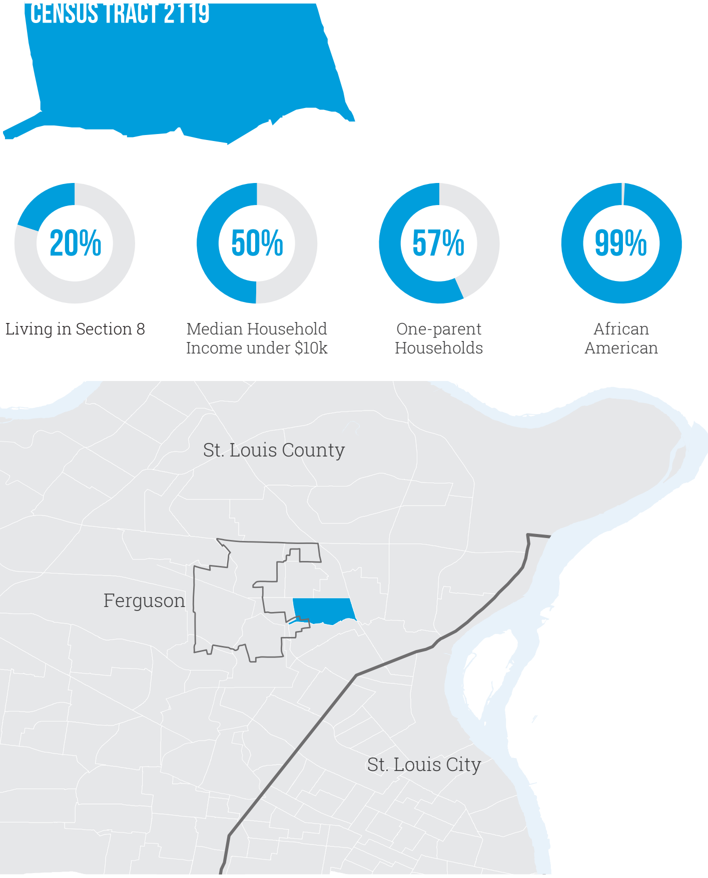
A 2014 audit of the Missouri Low-Income Housing Tax Credit showed that Missouri has the highest per capita outlay of state tax-credit authorizations in the nation (Young, 2014). Missouri is only one of two states with a per capita outlay exceeding $20, while six of the ten states including California, Massachusetts, and New York spent less than $5.14 per capita (Young, 2014). The cause for concern is not the absolute figure spent on state tax credits, but rather the amount of money, or lack thereof, that is spent on actual housing construction. This most recent audit found that only 42 cents of every dollar Missouri spends on the program goes toward the physical construction of affordable housing (Bogan, 2014). The rest is lost to federal taxes and syndicators, and offsets the discount investors require when receiving the tax credits over a period of ten years. This current model for financing LIHTC development offers an effective interest rate of over 19 percent. The interest rate is so high because of the time value of money and the smaller pool of players looking to write down their state tax obligations compared to those using the federal credit. Additionally, using a state tax credit actually writes down an investor's federal tax bill, which diminishes the value even further.

State spending for the LIHTC program is so high in Missouri because it is one of only two states that do not cap the amount of authorized tax credits in a given time frame. Based on levels of current spending, the state projects that it will authorize $3.4 billion credits through 2020 and investors will redeem $2.1 billion (Montee, 2008). Therefore, while the state is able to produce marginally more housing, it does so at a cost of $61,000 per unit. Another cause for concern about the way the state tax-credit system operates is that the Missouri Housing Development Commission (MHDC) does not disclose how tax credit projects are selected. The state follows a QAP, but Missouri is one of only four states that does not use some type of scoring system in the project evaluation and selection process (Montee, 2008). The MHDC received recommendations in both 2007 and 2008 from the Missouri State Auditor and the Governor's White Ribbon Panel to standardize the scoring process, but it still has not made any changes. MHDC staff have stated several times that a scoring system is not used so as to avoid receiving applications from developers who try to score the most points



Maps 2-3

Section 8 Voucher Expansion in St. Louis. Dots are sized proportionally to the number of rental units in which a tenant has a voucher. Source: HUD, 2015.



Map 4

Demographic information from Census Tract 2119 in Ferguson, Missouri. Sources: St. Louis Post-Dispatch; ACS (2008-2013).

possible (Montee, 2008). However, the lack of a scoring system prevents transparency and adds a layer of subjectivity to the whole selection process.

Not only are credits allocated at the sole discretion of the MHDC, but the commission also does not disclose project cost information to the public until after projects are approved. This means that even though the state has the highest per capita outlay for tax credit housing in the United States, the Missouri public does not see the total cost comparison amongst all project applications, and never sees the projected project cost for applications not selected.

Taken together, these transparency issues have strengthened the perception that the MHDC is heavily swayed by campaign contributions and political influence during the project selection process (Montee, 2008). The State Auditor and the state's Ethics Commission have looked into this situation on several occasions and cited the difficulty of matching and identifying the source of campaign contributions as the reason this speculation has been neither officially confirmed nor denied (Montee, 2008). With the amount of private money invested in affordable housing, however, the process becomes quite difficult to change at the state level. Bills introduced in the state legislature to scale back Missouri's program have died each of the past four years, with no current proposal on the table to make any changes (Young, 2014).

Missouri's QAP has also come under intense scrutiny in recent months because of the way it implicitly encourages poverty concentration. In addition to providing a basis boost to Qualified Census Tracts, the Missouri QAP also requires developers to submit a market study dated within six months of the application due date (MHDC, 2013). A contested metric in these market studies is the capture rate of the proposed development, which is required under Development Characteristics §3b of the QAP. The capture rate determines the demand for an individual project based on a given area. This means that if there are more individuals living within the primary market area who qualify for the proposed development, the result will be a more favorable capture rate. Because the MHDC does not disclose how it scores different development characteristics, a developer is left to maximize the project's metrics, which includes the capture rate (Clarke, 2014).

The result of the QAP's ambiguity has led to speculation that the LIHTC program has contributed to pockets of severe poverty in the state's major metropolitan areas. The *St. Louis Post-Dispatch*, with data courtesy of the MHDC, recently published a series of maps showing the relationship between the incidence of low-income housing and median household income in the St. Louis area. The most noticeable cluster of low-income housing falls in an area near the famed Pruitt-Igoe site in North St. Louis, which also happens to include the city of Ferguson. Within one of Ferguson's census tracts, 20 percent of the population lives in Section 8 housing, over 50 percent of households have median incomes of less than $10,000, 57 percent are one-parent households, and 99 percent are African-American. Two of St. Louis' largest LIHTC projects are within blocks of each other, together totaling over 774 units. The QAP may not directly cause this concentration of poverty, but the lack of a scoring system makes this area desirable for development according to a number of the plan's metrics.

This most recent audit found that only 42 cents of every dollar Missouri spends on the program goes into the physical construction of affordable housing (Bogan, 2014).

STATE REFORM

At the state level, the MHDC and the Missouri State Legislature could reform the LIHTC program in several ways without compromising the organization's mission to strengthen communities through the development and preservation of affordable housing (MHDC, 2007). Of primary concern is the need to cap the number of credits or increase the value of the state credit so more money is spent on the actual construction of affordable housing. One possibility, suggested by Governor Jay Nixon's low-income housing panel, is to cut the credit's payback period from ten years down to five. This would increase the buying power of the credit and, as the commission reported, fund 30 percent more housing units for the same amount of money (MHDC, 2007). Alternatively, five bills in the Missouri House and Senate in the past two years have considered capping tax credit authorizations, but none of these have passed. A more politically feasible solution might be a technical restructuring of the credit, which would minimize federal tax implications for investors and lower the effective interest to a more reasonable level (Montee, 2008).

The second tier of necessary reform comes in the process of project selection. A uniform and transparent scoring system provides a level of consistency and cross-comparability when evaluating both proposed and selected projects (Montee, 2008). Additionally, the MHDC needs to make more information, such as proposed project costs, available to the public before project selection. Together, these two recommendations eliminate the possibility for political influence in project selection and allow the public to engage with and respond to the process for prioritizing new LIHTC development.

Lastly, the state should revise the QAP to help deconcentrate poverty and create more mixed-income communities. Missouri currently gives basis boosts to projects in "high-growth" areas, but this ignores issues of access to high-quality schools and public services. Assessing a project's strength on accessibility to transit, schools, and other amenities would serve a more effective purpose than looking at areas with high concentrations of poverty as dictated by the QCT's definition.

The MHDC also needs to limit LIHTC development in Qualified Census Tracts and Difficult Development Areas that do not truly possess a community revitalization plan. Currently, developers can point to outdated master plans as fulfilling the necessary requirements for such a plan, even if communities do not actively adhere to these plans. The solution is to either eliminate the community revitalization plan requirement or mandate that communities update their plans more frequently. In total, the goal of these statewide reforms is to increase the efficiency of the tax credit program through both fiscal and social responsibility, as well as increase total transparency.

CONCLUSIONS

The LIHTC program has been an effective mechanism for providing affordable housing in the United States. Permitting states to decide how these credits are allocated is important, but states can still do more to improve the social fabric in the areas where they locate development. State priorities as outlined in the QAP are vitally important to determining where these projects are located and how they affect the neighborhoods. It is the responsibility of these designated state agencies to effectively integrate affordable housing within our communities and establish a transparent selection process. The extent to which they can accomplish these changes will most certainly affect the longevity of the LIHTC program. ■

REFERENCES

2014 Qualified allocation plan for MHDC multifamily programs. Rep. N.p.: Missouri Housing Development Commission, 2013. Print.

Bogan, Jesse. "As low income housing boomed, Ferguson pushed back." St. Louis Post Dispatch (2014): n: pag. Web.

Bray, Timothy. "The QAP as policy lever" The Institute for Urban Policy Research at the University of Texas at Dallas (2011): n. pag. Web.

Clarke, Ross. The low income housing tax credit: Challenges presented by the onset of year 15 in the St. Louis region, Washington University, 2014. Print.

Cook, John. Cost/benefit analysis of the Missouri low-income housing tax credit program. Rep. N.p.: BKD, LLP, 2007. Print.

Desai, Mihir. "Tax incentives for affordable housing: The low income housing tax credit." Tax Policy and the Economy 21.1 (2010): n. pag. JSTOR. Web.

Gramlich, Ed. "Qualified allocation plan." National Low Income Housing Coalition (2014).

Khadduri, Jill. "Creating balance in the locations of LIHTC developments." Poverty and Race Research Action Council (2013): n. pag. Web.

Montee, Susan. Analysis of the low income housing tax credit Program. Rep. N.p.: Missouri State Auditor, 2008. Print.

Schwartz, Alex. "After year 15: Challenges to the preservation of housing financed with low-income housing tax credits." Metropolitan Institute at Virginia Tech 19.2 (2008): n. pag. Web.

Shimberg Center for Affordable Housing. The low income housing tax credit and multifamily bond financing, "The Florida Housing Finance Corporation" (2001) n. pag. JSTOR. Web.

Wallace, James. Evaluating the low-income housing tax credit. Rep. N.p.: Jossey-Bass, 1998. Print.

Young, Virginia. "High cost, low benefit of Missouri housing tax credit assailed in audit." St. Louis Post Dispatch (2014): n: pag. Web.