Investing in Positive Social Impact

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Tax Credits and the Financialization of Urban Policy

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Tax Credits and Urban Redevelopment

- **1976** Historic Tax Credits (HTC)
- **1986** Low Income Housing Tax Credits (LIHTC)
Tax Credits and Urban Redevelopment

1976  Historic Tax Credits (HTC)

1986  Low Income Housing Tax Credits (LIHTC)

2000  New Market Tax Credits (NMTC)

2017  Opportunity Zones
Tax Credit Investments

**HTC**

- **1978-2017**
- $144.6 billion in historic rehabilitation investment

**LIHTC**

- Since 1986
- financed over 3 million apartments and served 7 million households

**NMTC**

- Through 2016
- $44.4 billion in investments in low-income communities and businesses


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Tax Credit Investments in New Orleans

- Transformed the Warehouse District and CBD
- New Orleans among the top cities with HTC rehab activity
  - Over 560 certified projects completed between 1992 and 2012
- $2.6 billion in NMTCs allocated to projects in LA through 2018
  - Leveraged an additional $2.6 billion in investment

Tax Credits & Hurricane Katrina Recovery

The Go-Zone legislation expanded HTC, LIHTCs & NMTCs in disaster impacted areas

- Increased the % of credit for qualified rehabilitation expenditures (from 20 to 26%)
- Allocated an extra $1.7 billion in LIHTCs to Louisiana (Novogradac, 2015)
- Allocated an extra $1 billion in NMTCs
  - $734 million in NMTC investments made in New Orleans (Nelson & Houtman, under review)

Strengths of Tax Credit Programs

- Programs have had substantial impacts
- Programs are flexible
  -- Not all communities need the same intervention
- Do not register as an expense in the general budget
  -- Operate ‘below the radar’
- Considered an efficient use of federal dollars
  -- Leverages private sector investment
  -- Brings market discipline, oversight & accountability to projects
- Developers combine tax credits
**Critiques**

- **Programs are complex**
  -- Structures involving leverage or the combination of tax credits are especially complex

- **High administration costs**
  Expensive to:
  -- Apply for & win allocations
  -- Set up infrastructure to make investments & monitor compliance

- **High transaction costs**
  -- Often necessitates sophisticated legal & accounting consultants

- **Dependent upon small number of large financial institutions**

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**Tax Credits and Financialization**

- **Increased dominance of financial actors and markets in urban policy and governance**
  
  -- Subordination of social concerns to investor returns and the interests of private investors (Gotham, 2016; Lake, 2014)

  -- Financial instruments or tools influence the focus, design and implementation of urban policy (Lake, 2015)
A Closer Look at LIHTC

• Doesn’t serve very low-income households

• Doesn’t incentivize mixed-income housing

• Incentivizes concentration in high-poverty areas

A Closer Look at NMTC

• No defined role for local government; power and control over investment decisions shifted to financial market actors

• Vague program goals and flexibility in location and type of projects has resulted in projects that have had questionable impact on low-income communities

• Tax credit recapture provisions have led to prevalence of large real estate investments

• Highly leveraged financial structures raise concerns that investors may be earning excessive returns on their equity investments
The Affordable Housing Crisis

FIGURE 2: RENTS ARE OUT OF REACH FOR MANY RENTERS

<table>
<thead>
<tr>
<th>Rent Affordability Category</th>
<th>2018 One-Bedroom FMR</th>
<th>2018 Two-Bedroom FMR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rent Affordable to a Household Relying on SS</td>
<td>$250</td>
<td>$1,149</td>
</tr>
<tr>
<td>Rent Affordable to a Household with One Full-Time Worker Earning the Federal Minimum Wage</td>
<td>$377</td>
<td></td>
</tr>
<tr>
<td>Rent Affordable to Extremely Low Income Household</td>
<td>$660</td>
<td></td>
</tr>
<tr>
<td>Rent Affordable to Full-Time Worker Earning the Average Renter Wage</td>
<td>$878</td>
<td></td>
</tr>
</tbody>
</table>

Fair Market Rent – Fair Market Rent, defined by the U.S. Department of Housing and Urban Development as the maximum rent a household can pay and still spend less than 30% of its income on housing costs. Affordable rent for average renter wage is based on a 30% income level. Affordable rent for average renter wage is based on a 30% income level and average Social Security Administration, 2018.

Photo credit: Nola.com | The Times-Picayune

The Affordable Housing Crisis

**LOUISIANA**

In Louisiana, the Fair Market Rent (FMR) for a two-bedroom apartment is **$865**. In order to afford this level of rent and utilities — without paying more than 30% of income on housing — a household must earn **$2,883** monthly or **$34,597** annually. Assuming a 40-hour work week, 52 weeks per year, this level of income translates into an hourly Housing Wage of:

$16.63

**STATE RANKING #29**

### FACTS ABOUT LOUISIANA:

<table>
<thead>
<tr>
<th>STATE FACTS</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Minimum Wage</td>
<td>$7.25</td>
</tr>
<tr>
<td>Average Renter Wage</td>
<td>$14.07</td>
</tr>
<tr>
<td>2-Bedroom Housing Wage</td>
<td>$16.63</td>
</tr>
<tr>
<td>Number of Renter Households</td>
<td>598,613</td>
</tr>
<tr>
<td>Percent Renters</td>
<td>35%</td>
</tr>
</tbody>
</table>

- **92** Work Hours Per Week At Minimum Wage To Afford a 2-Bedroom Rental Home (at FMR)
- **76** Work Hours Per Week At Minimum Wage To Afford a 1-Bedroom Rental Home (at FMR)
- **2.3** Number of Full Time Jobs At Minimum Wage To Afford a 2-Bedroom Rental Home (at FMR)
- **1.9** Number of Full Time Jobs At Minimum Wage To Afford a 1-Bedroom Rental Home (at FMR)

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New Orleans has **47** affordable rental units for every 100 extremely & very low income residents.

- **58%** of households pay one-third or more of their monthly income on housing costs
- **37%** of households pay one-half or more of their monthly income on housing costs

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Median monthly housing costs:

- **$1,053** for Owners
- **$927** for Renters

Annual household income needed to afford rent: **$38K**

Average annual income for 71% of workers: **$35K**

Average annual income for service workers: **$23K**

Annual income for 30%+ of local musicians: **$10K**

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*Image of a map showing housing statistics.*
Race & the affordable housing crisis

Estimated People Displaced

The Expansive Effect of Evictions Ordered in New Orleans, LA

From January 2015 to June 2018, an estimated 24,660 people have been displaced, derived from evictions ordered and average rental household size, and excluding evictions ordered on the same tenant.

New Orleans East is particularly affected by apartment complexes with massive counts of evictions.

Estimated Count Displaced

- Approximated by City Block
  - < 10
  - 10-50
  - 50-250
  - > 250

Race & the affordable housing crisis

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## Affordable Housing & the IRS

### Low Income Housing Tax Credits
- Tax credits available for housing developers who reserve a percentage of the property for lower income renters

### Opportunity Zones
- Tax Cuts and Jobs Act of 2017
- Tax benefits for development in “distressed” communities in the form of deferral of capital gains taxes

## Low Income Housing Tax Credits (LIHTC)
- The primary way that “affordable” housing is developed in the U.S. today
- Average of around 109,000 units placed in service annually between 1995 and 2016 (source: hud.gov)
- Frequently layered with other subsidies, such as public housing and tenant-based Section 8
### How does LIHTC work?

- Developers apply for tax credits through state housing finance agency (“HFA”) once a year
- Applications are evaluated under the agency’s Qualified Allocation Plan (“QAP”)
- Applications are awarded points based on different factors, such as percentage of affordable units, and length of commitment to affordability

### Length of Commitment

- Once a property awarded LIHTC is placed in service, the property is subject to an initial compliance period of 15 years, and an extended use period of an additional 15 years, for a total of 30 years.
- Post-1989 all LIHTC properties are subject to minimum 30 year commitment (through extended use period) except in 2 circumstances.
- Properties must comply with tenant protections until 3 years after termination of the extended use period
Tenant Protections

- **Rent subsidy** - LIHTC developers commit to subsidizing housing for family at or below a particular percentage of AMI. A “60%” unit is for people at 60% AMI or below. People who qualify for a 60% unit must pay a flat rent calculated to be roughly a third of the income of an imaginary person at 60% of AMI. Typically properties are 20/50 (20% at 50% of AMI) or 40/60 (40% at 60% of AMI).

- **No cause evictions** - Landlord cannot elect to not renew a tenant’s lease for no cause.

- **Physical condition standards** - Landlord must comply with state and local housing codes and HUD physical condition standards.

How does the owner get out of its commitment?

- The owner of a LIHTC property can exit its commitment after the first 15 years through:
  1. Foreclosure
  2. Qualified Contract: In year 14, the owner can approach LHC for someone to buy out the affordable portion of the building. If LHC cannot find a “qualified contract,” the owner is released from commitment

- **Louisiana**: Louisiana properties post-Katrina agreed to forgo their right to seek a qualified contract until year 30 or 35 as part of the application process, or committed to a minimum 35-50 year affordability period via a secondary deed restriction
Limitations of LIHTC as a solution

- Expiring subsidy vs. permanent affordability
- Early exit schemes
- Owner compliance issues & lack of regulatory guidance
- Problematic new developments: Income averaging

Expanding Subsidy vs. Permanent Affordability

- 2001: Received $29 million in state tax-exempt bonds in return for 15 year commitment
- 2016: 53 low-income households receive eviction notices
Early Exit Strategies: Legal . . .

- In year 14 owner can seek Qualified Contract for low-income portion
- State HFA (subject to public comment) controls ease/difficulty of QC application process
- Whether QC is possible depends on availability of potential buyers and availability of financial incentives for potential buyers

... and illegal

- Michigan legal aid filed RICO case against Michigan company, Eenhoorn, that “planned” foreclosures to escape LIHTC obligations
- When company fell into financial distress executed deed in lieu of foreclosure, transferring deed to lender... another company tied to Eenhoorn
Owner Compliance Issues

(ii) Eviction, etc. of existing low-income tenants not permitted The termination of an extended use period under clause (i) shall not be construed to permit before the close of the 3-year period following such termination—

(I) the eviction or the termination of tenancy (other than for good cause) of an existing tenant of any low-income unit . . .


- Lack of any regulatory guidance from the IRS (or HUD)
- Issues with layered subsidies – ex: multifamily management companies unfamiliar with public housing tenant protections; conflicts between LIHTC rules and second subsidy program rules

New developments: income averaging

- Consolidated Appropriations Act of 2018 added income averaging as a third set-aside option.
- Instead of having 100% rent-restricted LIHTC units set aside for people at 50-60% of AMI, property can now rent LIHTC unit to family up to 80% of AMI as long as total rent-restricted units average to 60%.
- Good news: more subsidized units for people between 10 and 50% of AMI.
- Bad news: net reduction of units affordable to families under 60%; could reduce units available to Section 8 voucher-holders.
Opportunity Zones (OZ)

- 2017 Tax Cuts and Jobs Act
- Designed to spur investment in “distressed” communities through tax benefits
- Identified 8,761 across the country
- Investors can defer tax on capital gains until 12/3/21 by making an investment in an opportunity zone through a Qualified Opportunity Fund (“QOF”)

Limitations of OZ as a solution

- Concerns about gentrification and displacement of low and middle income families as development impacts property values
- … time will tell
- Letter from NCSHA [https://www.ncsha.org/wp-content/uploads/2018/11/NCSHA-OZ-Comment_101818.pdf](https://www.ncsha.org/wp-content/uploads/2018/11/NCSHA-OZ-Comment_101818.pdf) asked IRS to clarify that (1) residential real estate qualifies as OZ property; (2) can be combined with other credits to facilitate affordable housing development; and (3) OZ investments that eliminate affordable housing units in a designated OZ without development of equal # of replacement units constitutes prohibited abuse under the program.
Addressing the limitations

• Investment in permanent or longer-term affordability (ex. community land trusts)
• Need for regulatory guidance
• Importance of affordable housing protections in geographic areas where economic development is incentivized

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