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To Reduce Corporate Welfare, Kill the Low-Income Housing Tax Credit

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The federal government redistributes hundreds of billions of tax dollars annually to various housing programs, and provides billions in housing subsidies through various tax breaks. One of the more wasteful of such subsidies is the low-income housing tax credit (LIHTC), a form of corporate welfare created by the Tax Reform Act of 1986.[1]

The Consolidated Appropriations Act of 2018 expands the LIHTC, thus ensuring that large developers and investors will continue to benefit at the expense of all other taxpayers, including those the credit is intended to help. Going forward, federal policymakers should limit the federal government's involvement in the U.S. housing market, including ending the inefficient and poorly targeted LIHTC.

The Low-Income Housing Tax Credit

The federal government annually spends—directly and indirectly—hundreds of billions of dollars on various housing subsidies, as direct outlays and through the tax code. One of the single largest tax programs is the LIHTC, a subsidy program that cost federal taxpayers $8.3 billion in 2017.[2] Proponents argue that the LIHTC is a "successful public-private partnership"[3] that helps low-income individuals, but research shows that the LIHTC is a costly and inefficient corporate welfare program that has failed to boost the U.S. housing stock.

The LIHTC is a complex program that has spawned a cottage industry of lawyers and accountants focused on helping firms maximize their tax credits.[4] Under this program, the federal government uses a state-population-based formula to provide tax credits to state agencies.[5] The individual state agencies then distribute credits to individual private developers who, in turn, sell credits to their investors. The precise amount of the allowable credit varies, but the LIHTC provides a "70 percent present value credit for certain new buildings," and a "30 percent present value credit for certain other buildings."[6]

Essentially, the LIHTC subsidizes up to 70 percent of the costs of a private development that qualifies for the credit.[7] To qualify for the credit, private developers must adhere to both state and federal rules, but generally must set aside a certain portion of the units as rent-controlled housing for tenants earning below certain income values. Developers are required to meet either a "20–50" test or a "40–60" test.[8] Under the 20–50 test, for instance, developers must ensure that at least 20 percent of the housing units are rent-controlled and have tenants with incomes less than 50 percent of the area's median gross income.

LIHTC Fails to Help Those in Need, Subsidizes Investors

The value of the LIHTC is largely captured by investors and intermediaries, not renters. Thus, even if federal or state governments decide that low-income renters indeed need a subsidy worth $8

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billion a year, the LIHTC is an inefficient way to distribute the money. In the *Journal of Real Estate Economics*, Gregory Burge estimates that only 35 percent of the tax credit is captured by renters in the form of lower rent.[9] Combining Burge's estimates with those of other scholars, economist Ed Olsen estimates "that tenants capture at most 24 percent of the development subsidies" for low-income housing.[10]

The tax credit's demonstrated inability to accrue to renters has been known for decades. In a 1992 report, the Congressional Budget Office explains that much of the LIHTC benefit flows to investors rather than tenants. The government report concludes that "housing that is subsidized through credits is more suited to the needs of investors than poor renters."[11] In recent years, nearly all of the credits from the LIHTC program are claimed on corporate tax returns,[12] and approximately 85 percent of total LIHTC equity investments are made by banks, with the five largest U.S. banks accounting for half that total.[13]

LIHTC Crowds Out Private-Sector Housing, Distorts Markets

One major difficulty in assessing the effectiveness of the LIHTC is that many of the low-income housing units financed with these credits would have been financed anyway. Recent research suggests it is very likely that "nearly 100% of LIHTC development is offset by a reduction in the number of newly built unsubsidized rental units."[14] Thus, while the U.S.

1. Section 252 of the Tax Reform Act of 1986, Public Law 99–514, October 22, 1986, 100 STAT. 2086. See 26 U.S. Code § 42.
2. Office of Management and Budget, Analytical Perspectives, Budget of the United States Government, Fiscal Year 2019, "Tax Expenditures," https://www.whitehouse.gov/wp-content/uploads/2018/02/ap_13_expenditures-fy2019.pdf (accessed March 26, 2018). Total annual allocations have increased from a low of $981 million in 1987 to an estimated $8.4 billion for 2018. Table 13-1, https://www.whitehouse.gov/wp-content/uploads/2018/02/ap_13_expenditures-fy2019.pdf (accessed March 26, 2018).
3. Jane Graf, Michael Bodaken, Patrick Sheridan, and Terry Parker, "Don't 'Kill' the Low Income Housing Tax Credit, Expand It," Affordable Housing Finance, September 22, 2017, http://www.housingfinance.com/policy-legislation/dont-kill-the-low-income-housing-tax-credit-expand-it_o (accessed March 22, 2018).
4. One accounting firm's guide to the LIHTC is more than 1,400 pages long. Chris Edwards and Vanessa Brown Calder, "Low-Income Housing Tax Credit: Costly, Complex, and Corruption Prone," Cato Institute *Tax and Budget Bulletin* No. 79, November 13, 2017, p. 2, https://www.cato.org/publications/tax-budget-bulletin/low-income-housing-tax-credit-costly-complex-corruption-prone (accessed March 22, 2018). Edwards and Calder provide a comprehensive review of the LIHTC.
5. 26 U.S. Code § 42(h)(3).
6. 26 U.S. Code § 42(b). The 70 percent subsidy for newly constructed rental housing is provided via the so-called 9 percent credit, and the 30 percent subsidy is provided via the so-called 4 percent credit. See Mark Keightley, "An Introduction to the Low-Income Housing Tax Credit," Congressional Research Service *Report* RS22389, May 31, 2017, https://fas.org/sgp/crs/misc/RS22389.pdf (accessed March 22, 2018).
7. The tax credit can be higher for developments that meet special "high cost" area requirements. 26 U.S. Code § 42(d)(5)(B). For instance, LIHTC projects located in areas designated as either a "Qualified Census Tract" or a "Difficult Development Area" qualify for a credit subsidy of up to 91 percent. See Michael D. Eriksen, "The Market Price of Low-Income Housing Tax Credits," *Journal of Urban Economics*, Vol. 66 (2009), pp. 143 and 144.
8. 26 U.S. Code § 42(g)(1)(A) and § 42(g)(1)(B), respectively.
9. Gregory S. Burge, "Do Tenants Capture the Benefits from the Low-Income Housing Tax Credit Program?" *Real Estate Economics*, Vol. 39, No. 1 (Spring 2011), pp. 71–96.
10. Ed Olsen, "Does Housing Affordability Argue for Subsidizing the Construction of Tax Credit Projects?" presentation at American Enterprise Institute conference, April 6, 2017, p. 2, http://eoolsen.weebly.com/uploads/7/7/9/6/7796901/olsenaeihousingaffordabilityconferencepanel12rev.pdf (accessed March 26, 2018).
11. Congressional Budget Office, "The Cost Effectiveness of the Low-Income Housing Tax Credit Compared with Housing Vouchers," April 1992, p. 2, https://www.cbo.gov/publication/16375 (accessed March 26, 2018).
12. "Analytical Perspectives: Budget of the U. S. Government Fiscal Year 2018," Table 13-2A, p. 136, https://www.whitehouse.gov/sites/whitehouse.gov/files/omb/budget/fy2018/spec.pdf (accessed March 25, 2018).
13. CohnReznick, "The Community Reinvestment Act and Its Effect on Housing Tax Credit Pricing," 2013, pp. 3 and 15, http://ahic.org/images/downloads/Research_and_Education/the_community_reinvestment_act_and_its_effect_on_housing_tax.pdf (accessed March 25, 2018).
14. Michael Eriksen and Stuart S. Rosenthal, "Crowd Out Effects of Place-Based Subsidized Rental Housing: New Evidence from the LIHTC Program," *Journal of Public Economics*, Vol. 94 (2010), pp. 953–966. Also see Nathaniel Baum-Snow and Justin Marion, "The Effects of Low Income Housing Tax Credit Developments On Neighborhoods," *Journal of Public Economics*, Vol. 95 (2009), pp. 654–666, and, for additional research, Edwards and Calder, "Low-Income Housing Tax Credit."

Department of Housing and Urban Development touts that nearly 3 million housing units were placed in service between 1987 and 2015 using LIHTC projects, it could be the case that 3 million such housing units would have been built without the LIHTC.

LIHTC Is Federal Rent Control in Disguise

In addition to likely displacing private investment one for one, the LIHTC may further decrease the housing supply. The unintended consequences of rent control are the most ubiquitous example of well-intended policy worsening a problem rather than resolving it. When rents are artificially restricted below market rates, as they are under the LIHTC, the supply of other low-cost housing is cut back, and rents not covered by the rent-control rules tend to increase.[15] Would-be competitors are not willing to supply unsubsidized properties because the market rents necessary to build, renovate, and maintain similar housing are depressed by the supply of federally subsidized housing.[16]

Other Policies Do Help Renters

Subsidies, direct or indirect, are not the most effective way to support communities in need of more affordable housing. Instead, deregulatory reforms, such as local zoning and building code reforms, can be a powerful tool to expand housing supply and lower rental prices. Current policies in most large cities drive up housing costs due to strict rules and regulations that effectively prohibit new low-cost construction or renovations. Without new construction, housing costs rise and people are quickly priced out of the market, creating large reductions in economic welfare.[17] The LIHTC and other housing subsidies are largely treating the symptom of high housing costs, rather than the cause of overly restrictive land-use regulations.[18] Reforms to make it easier to privately build and finance new and expanded housing developments of any type would go a long way toward relieving the current upward pressure on rent in America's cities.

Congress Should Terminate the LIHTC, the Omnibus Expands It

Since its inception as part of the 1986 tax reform, the LIHTC has proven ineffective and inefficient. Congress decided not to expand the tax credit under the Tax Cuts and Jobs Act of 2017, a small victory over the myriad business interests who lobbied to increase their subsidy. Following tax reform, the March 2018 omnibus spending bill expanded the credit program for four years at a cost of $2.8 billion over the 10-year budget window.[19] The omnibus also added a third allocation test criteria to the LIHTC, allowing developers to build units that include tenants earning up to 80 percent of area median gross income.[20]

Expanding a broken system of tax credits to benefit narrow business interests signals Congress' intention to continue the same broken approach to communities in need. It is time to repeal the LIHTC and focus on reducing artificial barriers to new housing supply.

Conclusion

The housing sector is a prime example of how restrictive regulations and subsidy programs are all but guaranteed to increase prices. Federal tax-

15. Rebecca Diamond, Timothy McQuade, and Franklin Qian, "The Effects of Rent Control Expansion on Tenants, Landlords, and Inequality: Evidence from San Francisco," NBER *Working Paper* No. 24181, January 2018, http://www.nber.org/papers/w24181 (accessed March 26, 2018).
16. Carl Horowitz, "Time to Let the Low-Income Housing Tax Credit Program Expire," Heritage Foundation *Issue Bulletin* No. 175, June 25, 1992, https://www.heritage.org/housing/report/time-let-the-low-income-housing-tax-credit-program-expire.
17. Chang-Tai Hsieh and Enrico Moretti, "Housing Constraints and Spatial Misallocation," National Bureau of Economic Research *Working Paper* No. 21154, May 2015, http://www.nber.org/papers/w21154.pdf (accessed March 26, 2018).
18. Vanessa Brown Calder, "Zoning, Land-Use Planning, and Housing Affordability," Cato *Policy Analysis* No. 823, October 2017, https://www.cato.org/publications/policy-analysis/zoning-land-use-planning-housing-affordability (accessed March 26, 2018), and John L. Ligon, "Federal Reforms Should Include Housing and Land-Use Deregulation," Heritage Foundation *Backgrounder*, forthcoming.
19. The Joint Committee on Taxation, "Estimated Budget Effects of the Revenue Provisions Contained in the House Amendment to the Senate Amendment to H.R. 1625 (Rules) Committee Print 115-66)," JCX-7-18, March 22, 2018, https://www.jct.gov/publications.html?func=startdown&id=5065 (accessed March 26, 2018).
20. See Sections 102 and 103, Division T, "House Amendment to the Senate Amendment to H.R. 1625," (Rules) Committee Print 115-66, http://docs.house.gov/billsthisweek/20180319/BILLS-115SAHR1625-RCP115-66.pdf (accessed March 26, 2018).

payers spend billions of dollars a year on a program that academic economists and government agencies agree is inefficient and poorly targeted. For more than 30 years, the LIHTC has provided large benefits to banks and well-connected construction firms without alleviating the need for low-income housing. In many parts of the country, the problem has only gotten worse. It is time to take a different approach.

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