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POLICY BRIEF:

COMMUNITY RECOVERY THROUGH TAX CREDITS

2013

S&S Cycle, Inc.; Viola, Wis.

TAX CREDITS AT A GLANCE

Together, the Housing Credit and NMTC attracted $14 billion in direct investment in 2012.

Housing Credits benefit the most vulnerable populations; 80 percent of the units are occupied by families making less than 50 percent of area median income.

Through 2011, NMTC investments have helped develop or rehabilitate over 109 million square feet of commercial real estate and community facilities in low-income communities.

NMTCs leverage greater than $8 of private capital for every dollar of federal subsidy.

The Housing Credit and NMTC investments collectively support over 160,000 jobs each year.

Overview

- Congress is currently considering a major overhaul of the tax code, with the objective of reducing tax rates to encourage economic growth.
- In this environment, a critical issue will be the future of the two largest drivers of investment into our nation's most distressed communities: the Low Income Housing Tax Credit (Housing Credit) and the New Markets Tax Credit (NMTC).
- In 2012, the Housing Credit and NMTC together attracted approximately **$14 billion** in direct investment for capital-starved communities – supporting neighborhoods and projects typically considered too risky or unprofitable for the private market.
- These investments provide families with decent homes, revitalize commercial corridors, build new schools and health centers, and support small business development and job growth – all in neighborhoods with the least economic opportunity.

Birth of the tax credits

- Supported on a broad bipartisan basis and signed into law by President Reagan, the Housing Credit was enacted as part of the Tax Reform Act of 1986, the last major overhaul of the tax code.
- Since then, it has financed the development of more than **2.6 million** affordable rental homes in every state and leveraged more than **$100 billion** in private capital.

- It is the country's most successful affordable housing production program – currently financing approximately **90 percent** of all affordable housing development nationwide.
- Building off the success of the Housing Credit, the NMTC was launched in 2000 as the next generation community recovery tool, providing financing for operating businesses, commercial real estate projects (including mixed-use, industrial, retail, manufacturing and office space), community facilities and for-sale housing.
- Through 2010, the NMTC has financed **3,500** businesses and real estate projects, developed or rehabilitated over **109 million** square feet of commercial real estate and community facilities, and has helped to create or preserve close to **360,000** jobs.

YWCA; Salt Lake City, Utah

Correcting market failures: How the credits work

- Investors infuse capital into projects in low-income areas by purchasing equity stakes tied to a portion of total project costs.
- The potential financial return achieved via the tax credit enables investment in projects that would not otherwise produce profitable returns (e.g., housing properties with significantly below-market rent, and community facilities with limited revenue streams).
  - » It's been demonstrated that a typical Housing Credit project would have to reduce its construction costs by 72 percent to be able to serve a low-income family at an affordable rent.
- Investors claim their credits over time (7-10 years) and cannot redeem their investments prior to specified time frames, helping to ensure the long-term viability of these projects in the community.

Children's Campus of Kansas City; Kansas City, Kan.

Ensuring local accountability: Why the credits succeed

- Investors – with their own capital at risk – impose underwriting and asset management oversight, resulting in projects that are financially strong.
  - » Housing Credit properties tend to outperform other real estate classes with occupancy rates topping 96 percent nationwide and a cumulative foreclosure rate of just 0.62 percent over the program's history.
- Investors and developers – not taxpayers – assume the financial risks of these projects. If projects do not meet performance benchmarks over time, tax credits are forfeited back to the Treasury.
  - » In the case of the Housing Credit, investors cannot even begin claiming credits until the apartments are fully occupied by low-income families with affordable rents and at federal property quality standards.
- The credits are locally responsive; they are not driven by federal bureaucracy.
  - » Housing Credit projects are chosen through state-administered competitions based on how well the properties serve the housing priorities of the state.
  - » NMTC allocation awardees are selected through national competition, but project selection is left to the discretion of the awardees, their investors and the localities in which they operate.

Competition leads to better results

- Both programs are dramatically oversubscribed.
    - » In 2012, NMTC applications topped **$21.9 billion** in requests for only **$3.5 billion** of investment authority.
    - » Applications for the Housing Credit typically outpace availability by 3 to 1, and in some states this ratio is as high as 7 to 1.
- This competition drives applicants to achieve better outcomes than are minimally required in program regulations. Most notably:
    - » Housing Credit properties must satisfy affordability requirements for at least 15 years after completion, but state allocating agencies generally do not approve projects unless they commit to at least 30 - 60 years of affordablility.
    - » Housing Credit units must be affordable to persons making less than 60 percent of area median income (AMI), but 42 percent of Housing Credit units are occupied by families making less than 30 percent of AMI and 80 percent are occupied by families making less than 50 percent of AMI.
    - » All NMTC investments must be made in qualifying low-income communities, but due to priorities instituted by the Treasury Department in the application process, 75 percent of investments have been made in communities characterized by *severe* economic distress.

Verso Paper Corp; Quinnesec, Mich.

CityLink Center; Cincinnati, Ohio

Investments would not be made without the credits

- Most federal tax benefits encourage business behavior that already directly aligns with their operational interests.
- These credits are unique in that they direct investments to activities in which companies would not otherwise invest in because: a) it does not further their normal business operations; and b) if not for the benefits provided in the tax code, they would not be profitable for the company.
- The GAO reported that an estimated 88 percent of NMTC investors said that they would not have made the same investment without the NMTC.

Credits go beyond benefiting taxpayers to address local needs

- These credits are unique in that the ultimate beneficiaries are the end users: the low-income family that is paying significantly below-market rent; the business in the low-income community that can now get capital to expand its operations; and the community residents that now have access to health care or other important community services.
- In countless instances, the investments made possible through these credits are often the first investments made in distressed communities, thereby catalyzing other investments in surrounding real estate and housing, and spurring a new cycle of recovery and economic growth.

If these tax credits were to disappear

- The market for developing affordable housing nationwide would crumble.
- Homelessness would increase.
- Over a hundred thousand jobs would be lost annually.
- Seniors on limited fixed incomes, low-income veterans, people with disabilities, farmworkers, entry-level retail employees, and many other populations would be much less likely to find an affordable home.
- Families would be forced to pay considerably more in rent, leaving far less available to be invested back into the economy.
- Many projects in low-income communities – including community facilities such as charter schools and health clinics – could not move forward.
- Catalytic development which often results from these investments would not occur, keeping low-income communities in economic distress.

Faubourg Lafitte; New Orleans, La.

Heatherwood Apartments; Cañon City, Colo.

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