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PUBLIC HOUSING

Projects Developed With Low-Income Housing Tax Credit Differ From Traditional Public Housing Development Projects

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149451

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Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to provide you with the results of our work on the low-income housing tax credit program as an alternative to the public housing program in developing public housing. Both programs are designed to develop housing through either acquisition of previously constructed housing or construction of new housing. Public Housing Authorities (PHA) are the primary developers and managers of publicly controlled housing for low-income households. Our work was mandated in the National Affordable Housing Act of 1990. We plan to issue a report on the results of our work this summer.

Because of declining federal funding, the number of housing units added to the nation's public housing stock decreased dramatically, from about 30,000 in 1981 to less than 3,000 in 1991. However, the housing needs of some low-income households remain unmet. In response to these unmet housing needs, some PHAs began using the tax credit program as a way to raise funds to cover some costs of developing additional publicly controlled housing.

The tax credit and public housing programs involve different methods of using federal funds for the development of low-income housing: the public housing program provides direct grants to PHAs from the Department of Housing and Urban Development (HUD) and the tax credit program provides federal tax credits to low-income housing developers. The programs also have different levels of federal involvement. Although HUD selects and works closely with PHAs that receive public housing development grants, there are few federal requirements for the development of projects with tax credits.

The objective of our work was to compare the two programs in terms of (1) tenant and project characteristics, (2) costs to the federal government, and (3) PHAs' administrative experiences when developing each type of project. We reviewed the nine PHAs nationwide that completed projects through both the public housing and the tax credit programs between 1989 and 1991. Because we reviewed a very limited number of projects, our findings cannot be generalized to all tax credit or all public housing projects.

In summary, the PHAs we reviewed used the tax credit program to serve different types of tenants and to develop different types of projects than the public housing development program. Most of the public housing units were used for families with children and were scattered through predominantly middle-income neighborhoods. However, the PHAs used the greater flexibility offered them with tax credits to develop more concentrated housing for the elderly as well as families and in a variety of neighborhoods, including low- and middle-income neighborhoods. In addition, the PHAs developed a greater variety of unit types under the tax credit program. Also, the tax credit projects needed federal operating funds, such as Section 8 subsidies, to serve tenants with incomes as low as those of tenants in public housing projects.

Although HUD grants covered virtually all of the costs of developing the public housing projects, tax credits only generated enough cash to pay for a little more than half of the costs of developing the tax credit projects. Our estimates at one PHA showed that if tax credits were used to serve households as poor as those in the PHA's public housing project the federal government would have to spend more per unit than it did for the public housing project.

PHAs had to overcome administrative obstacles to use each of the programs. According to four PHAs we visited, the greatest obstacle with the public housing program was the multitude of HUD regulations and procedures. With tax credits, the greatest obstacle was finding other funding sources, such as commercial loans, to cover development costs beyond that covered by the tax credit. However, at least two of the PHAs were able to develop housing quicker with the tax credit. With so few funds available through the public housing program, PHAs said the tax credit is a valuable tool for developing additional low-income housing.

BACKGROUND

The public housing program provides direct grants from HUD to PHAs to develop public housing. Most publicly controlled housing for low-income households has been developed with these grants. Under the tax credit program, which has been the primary alternative to these grants since the enactment of the Tax Reform Act of 1986, PHAs may raise funds for development by forming public-private partnerships with investors.

The tax credit program is used primarily by private for-profit and nonprofit housing developers. The program is administered by the Department of the Treasury and by state tax credit allocation agencies which select housing projects to receive tax credits. Only a few PHAs have used the program. According to the National Association of Housing and Redevelopment Officials, less than 4 percent, or 67, of the PHAs that responded to its 1991 survey had participated in the low-income housing tax credit program during 1989 and 1990.[1]

Under the tax credit program, developers such as PHAs and nonprofit organizations that have no tax liabilities convert their tax credit allocations into funds by forming partnerships with corporations or other private investors. The investors provide the developer with cash it can use for developing the housing and receive in return a federal income tax credit for 10 years.

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[1]All 3,400 PHAs in the country were surveyed and the response rate was approximately 50 percent.

Because tax credits are not intended to provide developers with the full amount of cash they need to develop housing, developers often take out commercial loans to supplement their tax credits. In contrast, the grant provided through the public housing program covers virtually all of the costs of developing housing. As shown in appendix I, the additional loans often needed to develop housing with the tax credit require that tax credit projects produce more rent than public housing projects with equivalent development and operating costs. While a public housing project's rents are devoted exclusively to covering its operating costs, a tax credit project's rents must cover both the costs of operating the project and paying off the loan taken out to cover development costs.

THE TAX CREDIT AND PUBLIC HOUSING PROGRAMS SERVE DIFFERENT TYPES OF LOW-INCOME HOUSEHOLDS

We found several differences in the types of low-income households served by the tax credit and public housing projects reviewed.

Tax Credit Projects Serve More Elderly, but Fewer Large Families

Before 1990, PHAs were encouraged to develop public housing for households with children and discouraged from developing public housing for the elderly by the Housing and Urban-Rural Recovery Act of 1983, according to the Director of Development in HUD's Office of Public and Indian Housing. As a result, very little public housing for the elderly was developed between 1983 and 1990. Although the National Affordable Housing Act of 1990 enabled more PHAs to develop public housing for the elderly, HUD continued to encourage PHAs to develop large public housing units because of substantial unmet housing needs reported among low-income families with children,[2] which were somewhat more likely to have serious housing problems than the elderly.[3] In contrast, the regulations governing the tax credit program do not encourage or discourage development of larger units or units for the elderly.

In the nine public housing projects we reviewed, only 2 percent of the units were occupied by elderly households and 98 percent by households with children. Conversely, in the nine tax

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[2]PHAs that plan to develop public housing units with at least three bedrooms receive extra points when HUD reviews their applications for funding. Applications with the greatest number of points are approved.

[3]Priority Housing Problems and "Worst Case" Needs in 1989, HUD (June 1991).

credit projects, more than 40 percent were occupied by elderly households and less than 60 percent by households with children.

Similarly, households served by the tax credit projects were substantially smaller in size than households served by the public housing projects. On average, the tax credit projects served two-member households, and the public housing project served four-member households.

Tax Credit Projects Need Operating Subsidies to Serve Tenants as Poor as Public Housing Tenants

Of the nine PHAs, those that used the tax credit to serve households with average incomes as low as those of the households in the public housing project needed operating subsidies from other federal programs. Unlike the public housing program, the tax credit program does not provide PHAs with an operating subsidy if tenants cannot provide enough rent to cover operating costs.

Five of the nine PHAs that we reviewed had used, or planned to use, federal subsidies from other programs, such as HUD's section 8 program, to cover the ongoing costs of their tax credit projects. Obtaining subsidies through other sources enables these PHAs to serve households in these projects with incomes as low as those for households in public housing. The four other PHAs that served low-income households with relatively higher incomes in their tax credit projects selected these tenants partially because they could provide enough rent to cover ongoing expenses.

THE TWO PROGRAMS PRODUCE SOME DIFFERENCES IN HOUSING CHARACTERISTICS

Because the development of tax credit projects is not subject to HUD's regulation and review as is the development of public housing projects, the nine PHAs we reviewed often chose different types of sites, neighborhoods, and units when they used tax credits.

Tax Credit Projects Were More Often on Single Sites

After observing the problems of concentrating households with children on single sites, HUD began to encourage PHAs to develop public housing for families on scattered sites in the early 1970s. PHAs that plan to develop scattered-site public housing units receive extra points when HUD reviews their applications for funding. No such incentive exists for the tax credit program. Without this incentive, developers may prefer single-site projects if their development and operating costs are lower than scattered-site projects.

Seven of the nine tax credit projects we reviewed, but only two of the nine public housing projects, were developed on single sites. However, of the seven single-site tax credit projects, three were exclusively for the elderly (for whom single-site housing is more appropriate, according to HUD) and one was a small transitional housing project for the homeless. The other three single-site tax credit projects served families and contained 42 to 144 units.

Tax Credit Projects More Often
Located in Low-Income and Minority Areas

HUD prohibits PHAs from developing additional public housing units in neighborhoods that already contain a high percentage of federally subsidized households or minority households. The tax credit program has no similar restrictions.

Five of the nine tax credit projects but only one of the public housing projects were in low-income neighborhoods. The other eight public housing projects were in predominantly middle-income neighborhoods. Similarly, while the tax credit projects were spread equally among minority, racially mixed, and white neighborhoods, only one of the public housing projects was in a minority neighborhood.

Greater Variety of Units Developed
Under the Tax Credit Program

A greater variety of types of units were developed through the tax credit program than through the public housing program. As shown in appendix II, most of the units developed through both programs were "attached homes"--town homes, duplexes, triplexes, and quadplexes. However, more than one-quarter of the tax credit units were of a type not found in the public housing projects--apartments in condominium and high-rise buildings and manufactured homes. HUD discourages PHAs from developing these types of units through the public housing program primarily because of density and durability concerns. But the tax credit program does not restrict developers' choices about unit types.

COSTS TO THE FEDERAL GOVERNMENT
FOR THE TWO HOUSING PROGRAMS DIFFER

HUD grants covered virtually all of the costs of developing the public housing projects we reviewed, while tax credits only generated enough cash to pay for about half of the costs of developing the tax credit projects, according to the PHAs we reviewed that had comparable development cost data available. Comparable cost data were available for eight of the public housing projects and seven of the tax credit projects. However, our analysis at the Housing Opportunities Commission of Montgomery County, Maryland (HOC) indicated that, relative to public housing,

using the tax credit program to serve households as poor as those in the PHA's public housing project would be more expensive for the federal government.[4]

Federal Government Covers Smaller
Percentage of Development Costs for Tax Credit Projects

The federal government covered less than 60 percent of the costs of developing the tax credit projects but virtually all of the costs of developing the public housing projects at the PHAs we reviewed. For example, at the Housing Authority of the County of Monterey (California), the cost of developing one public housing project was $4,206,798. Approximately 98 percent of that cost, or $4,119,925, was provided by HUD through a public housing development grant. The cost of developing the PHA's smaller tax credit project was $2,171,000. However, only 44 percent of that cost, or $948,000, was covered through the tax credit program by the cash contribution from the tax credit investors. To cover the remaining costs of developing tax credit projects, seven of the nine PHAs we reviewed had to obtain conventional loans or other subsidies.

Tax Credits Are a More
Expensive Way to Serve
Households With Similar Incomes

In our case study at the HOC of Montgomery County, Maryland, we determined that, for about the same level of federal expenditure per unit, households with much lower average incomes were served by the public housing project than by the tax credit project. These results are based on similar units the HOC acquired for both projects. Also, according to our estimates, it would cost the federal government a substantially higher amount to serve these very low-income households in the tax credit project.

According to our estimates, developing and operating the public housing and tax credit projects could cost the federal government similar amounts during their first 15 years--$72,000 and $67,000 per unit, respectively.[5] However, the public housing project serves lower income households, who paid an average monthly rent of $187, as compared with the $437 average monthly rent paid by households in the tax credit project in 1992.

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[4]In quantifying the development costs incurred for these projects, we included costs directly associated with the project and not costs incurred by federal agencies for overseeing the public housing and tax credit programs.

[5]These estimates represent the present value of federal government costs over 15 years discounted to 1990.

If the HOC wanted to use the tax credit project to serve tenants as poor as its public housing tenants, it would need additional federal funds such as rental subsidies from HUD's section 8 program, to cover its operating and debt service costs. We estimated that combining section 8 funds with the tax credit could cause federal expenditures to increase to as much as $91,000 per unit during the project's first 15 years, well beyond the costs of serving these tenants in the public housing project--$72,000.

Greater Administrative Fees and Returns to Investors With the Tax Credit Program

Using the tax credit, in the HOC case, is a more expensive way for the federal government to serve households as poor as those in public housing primarily because (1) higher administrative fees, such as lawyers' fees, were required when using the tax credit than when developing public housing and (2) the federal government pays a higher rate of return to obtain funds from the tax credit investor than the rate the Treasury pays to borrow funds for direct expenditures such as public housing grants.

Including the HOC, we visited four PHAs and all believed they used an unusually large portion of the cash provided by the tax credit for administrative costs. Although both the tax credit and public housing programs have some common administrative costs, tax credit projects may require payment of syndicator[6], legal, and accountant fees that are not typically required when PHAs develop public housing. For example, the three other PHAs we visited used from 2 to 10 percent of the cash raised from investors to pay fees to syndicators. Furthermore, a HUD study of 104 tax credit projects found that average syndication costs consumed 13.8 to 22.9 percent of the funds raised from the tax credit.[7]

The federal government is paying a higher rate of return to obtain funds from investors in the HOC's tax credit project than it pays on long-term Treasury securities.[8] However, estimating how much higher is subject to uncertainty because the rate depends on future tax benefits. For the HOC case, we made a series of assumptions and estimated that on a per-unit basis the value of the

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[6]Syndicators are outside firms hired to find investors for tax credit projects.

[7]Evaluation of the Low-Income Housing Tax Credit: Final Report, Feb. 1991.

[8]Investors in tax credits decide how much up-front cash they are willing to provide in return for the annual tax benefits they expect to receive. The rate of return they receive is the discount rate at which the present value of the cash contribution equals the present value of the anticipated annual tax benefits.

investor's projected tax benefits during the project's first 15 years could be $67,000, which substantially exceeds the investor's up-front cash contribution of about $52,000.[9] The $15,000 difference, calculated under our assumptions, reflects an estimated annual rate of return to the tax credit investor of approximately 17 percent--a rate substantially higher than the rate of 8.55 percent provided in 1990 on 10-year Treasury securities.

Our estimate of the value of the investor's projected tax benefits and the resulting rate of return may be high because we assumed that the investor would receive all of the tax benefits projected when the project began. If the investor's tax benefits are less than $67,000, the rate of return will be less than 17 percent. The investor's tax benefits might be less than $67,000 because of the risk of project noncompliance with tax credit program requirements or future tax law changes.[10] We believe the tax credit investor's rate of return will be higher than the Treasury's borrowing rate because of the investor's transaction costs, such as attorney fees that the investor might pay to participate in a tax credit project and the potential lack of competition among investors for the opportunity to participate in the tax credit program.[11]

The 17-percent estimated rate of return required by the investor in the HOC's tax credit project is not unusually high, compared with rates reported for other tax credit projects. During an earlier study on tax credits, the corporate investors we contacted told us that they required returns of 15-20 percent.[12] Furthermore, the HUD tax credit project study found that the average rate of return on tax credit projects paid to corporate investors was 19 percent. According to a housing expert, the syndication of tax credits will almost always raise less in cash from investors than the federal government provides in tax benefits

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[9]To make the anticipated future tax benefit stream comparable to the up-front cash contribution, which the investor paid to the PHA over 2 years, both were discounted to the beginning of 1990 using a discount rate of 8.25 percent.

[10]A project would not comply with tax credit program requirements if, for example, it encountered financial problems and was unable to continue serving low-income tenants.

[11]Competition for tax credits may be limited if few investors are notified that a developer, such as the HOC, is starting a tax credit project.

[12]Low-Income Housing Tax Credit Utilization and Syndication (GAO/T-RCED-90-73, Apr. 27, 1990).

because the typical private investor's required rate of return is higher than the government's opportunity cost.[13]

PHAs HAD TO OVERCOME ADMINISTRATIVE OBSTACLES TO USE EACH OF THE PROGRAMS

The four PHAs we visited had to overcome administrative obstacles to use each of the programs. These obstacles were somewhat offset in the tax credit program by the quicker development of projects for at least two of the four PHAs.

According to officials at the four PHAs, a variety of federal regulations and procedures for the public housing program greatly affected the way these projects were developed and sometimes slowed their completion.[14] Burdensome processing issues cited by the PHAs included HUD's site selection criteria, appraisal requirements, and limits on the amount of costs the PHA could incur when developing each unit. The PHAs also experienced delays when obtaining approvals from HUD staff on the many forms and documents HUD requires PHAs to submit when developing public housing. Despite these administrative burdens, officials at three of the four PHAs stated that the public housing development program--which has been in existence much longer than the tax credit program--was generally easier to use than the tax credit program.

Two of the four PHAs developed housing more quickly with the tax credit than through the public housing program.[15] The development time--from the date the PHA initially submitted an application to HUD or its state tax credit allocation agency for funds to the date that tenants occupied the units--was 1-1/2 to 3 years shorter for the tax credit project than for the public housing project at these PHAs.

According to the four PHAs, they faced a number of unique financial and administrative requirements when developing their tax

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[13]Michael A. Stegman, "The Excessive Costs of Creative Finance," Housing Policy Debate, vol. 2, issue 2, 1991, Fannie Mae. The government's opportunity cost is often equated with the Treasury borrowing rate.

[14]We did not determine whether PHAs' experiences were due to statutory requirements or to HUD's administration of the public housing program.

[15]We were unable to compare the development times for the tax credit and public housing projects at the other two PHAs we visited because these projects did not develop under typical circumstances. At one PHA, the projects were part of a large-scale housing replacement initiative. The other PHA obtained the tax credit and public housing units through a unique local government program.

credit projects. These PHAs experienced difficulties in securing investors for the tax credits and in obtaining the additional funding needed to cover project costs. Regardless of these difficulties, officials at three of the PHAs told us they planned to use the tax credit program again, stating that it is one of the only remaining ways they can raise funds to develop additional housing for low-income people.

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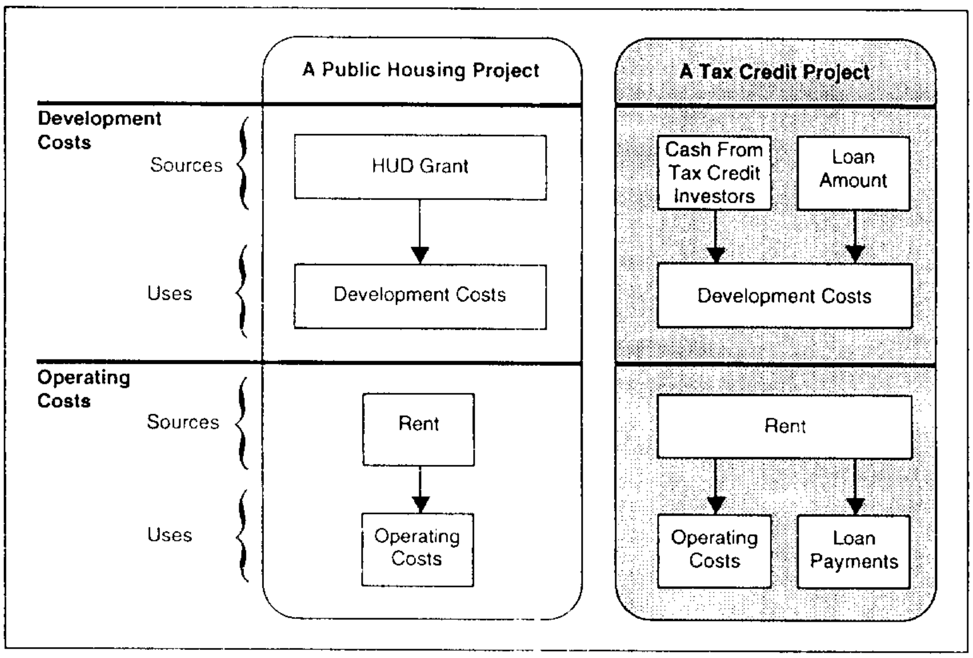
In summary, the PHAs we reviewed used the tax credit program to serve different types of tenants and to develop different types of projects than the public housing program. These differences are not surprising given the greater role played by the federal government during the process of developing public housing and in covering the costs of projects. Furthermore, if the cost inefficiencies suggested by our one case study occur with other tax credit projects, the tax credit may be a more expensive way than the public housing program for the federal government to serve very low-income households. Nevertheless, in this period of declining federal funds for the development of traditional public housing, the PHAs we reviewed found the tax credits a valuable resource.

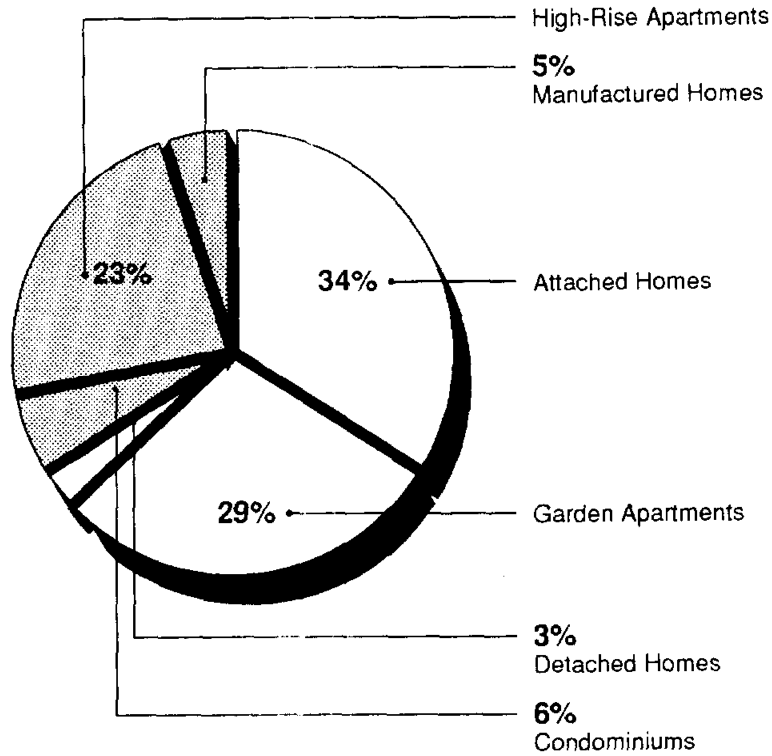
Mr. Chairman, this concludes my prepared statement. I would be glad to respond to any questions that you or any Members of the Subcommittee may have.

Sources and Uses of Funds for
Equivalent Public Housing and Tax Credit Projects

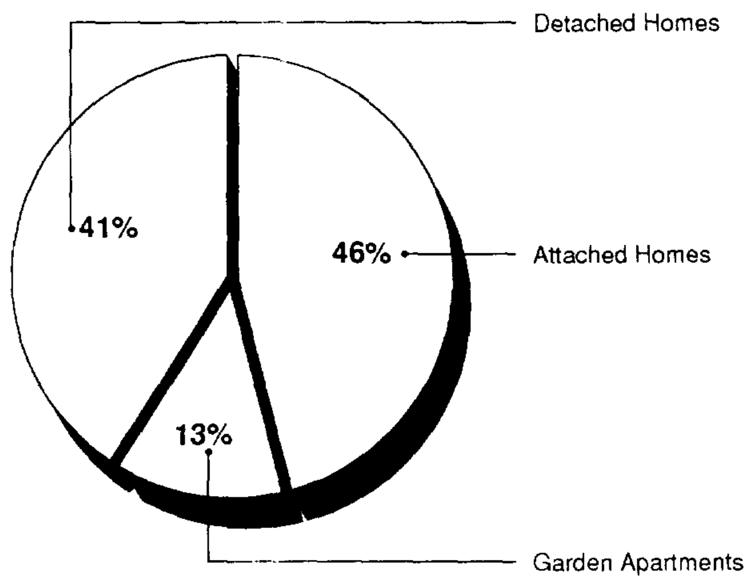


Types of Units Developed Through the Tax Credit and Public Housing Programs at Nine PHAs

Tax Credit Units



Public Housing Units



Types of Units not in the Public Housing

Types of Units in Both Types of Projects

"Attached Homes" includes town homes, duplexes, triplexes, and quadplexes. The condominium units were purchased by the tax credit partnership, although most of the surrounding units are privately owned and controlled and were sold at market rates.

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