The Low Income Housing Tax Credit (LIHTC) has been the federal government’s most successful program for producing quality rental housing for low-income families and individuals. It has created jobs, revitalized low-income communities, and expanded low-income families’ and individuals’ access to geographic areas that offer relatively good employment and educational opportunities. Affordable housing developers receive an allocation of housing tax credits through a competitive process, which they then sell to investors to raise equity for the project. Investors that purchase tax credits are able to reduce their federal tax liability dollar-for-dollar, so the purchase of $1,000 worth of tax credits reduces federal income tax liability by $1,000 (credits are typically sold at a discount, allowing investors to profit from the transaction). As a result of the equity made available through the sale of tax credits, the developer can complete the project with less debt and pass the cost savings on to the tenant in the form of lower rent.

By Buzz Roberts1, Local Initiatives Support Corporation

The LIHTC has been the federal government’s most successful program for producing over 2 million affordable rental homes while incurring an annualized foreclosure rate of less than 0.1 percent. Historically, the financial services sector has provided 80 to 90 percent of LIHTC investments, a result of its real estate financing expertise and regulatory mandates to address low-income needs. Fannie Mae and Freddie Mac have provided about 40 percent of LIHTC investments, and banks motivated by the Community Reinvestment Act (CRA) have also provided about 40 percent, led by the largest banks. Insurance companies and other investors have provided additional LIHTC investments.

The LIHTC program is now facing significant hurdles, however. Fannie Mae and Freddie Mac had stopped making new investments even before entering federal conservatorship last year. In addition, the substantial losses that many financial institutions have recently incurred have eliminated or reduced their ability to use tax credits.

Strengthening the Low Income Housing Tax Credit Investment Market

The Mews at Cascadia Village in Vancouver, WA, was financed through a combination of loans, grants, and equity from low-income housing tax credits.
current investors that cannot use tax credits are reportedly trying to sell their portfolios, and the mere prospect of such divestment is further destabilizing an already weak investment market.

credits. Since these credits are generally paid in equal amounts over a 10-year period, and the future tax liability of financial institutions has become more uncertain in the current environment, the risk that the investment will not be profitable because the tax credits cannot be claimed as scheduled is problematic for some financial institutions.

While some banks have kept investing, others have cut back substantially. In 2008, LIHTC-based investment dropped to about $4.5 billion, about one-half of the $9 billion invested in 2007. Many observers expect about the same level of investment or less in 2009. Moreover, current investors that cannot use tax credits are reportedly trying to sell their portfolios, and the mere prospect of such divestment is further destabilizing an already weak investment market.

The investors still in the market can take their pick of projects and command much higher rates of return. From a public policy perspective, however, that means each dollar of tax credit generates less capital for housing. Many high-priority deals are not getting done because they now have financing gaps, are perceived as too complicated or risky, are in locations that get less attention from CRA examiners, or involve potential bank investors that already have enough investments to meet their CRA needs. Although there is a shortage of LIHTC investment in most places, rural areas and smaller cities tend to be especially disadvantaged. As they retrench their portfolios into doing “safe” and “ordinary” deals, most investors are also shying away from complex projects that provide housing for the homeless or other special needs populations, as well as those that would preserve federally assisted housing or otherwise use federal rent subsidies.

The recently enacted American Recovery and Reinvestment Act provides temporary grant funds to jump-start stalled projects, but it does nothing to reactivate the investment market.

I propose three possible ways to attract private investment from both experienced and novice investors:

1. Congress could permit investors to “carry back” LIHTCs from existing projects for five years from 2009-2011 tax returns, provided the investors make new LIHTC investments of an equal amount. Under current law, an investor without enough tax liability in a given year to use the LIHTCs it has earned can “carry back” the credits one year by amending its tax return for the previous year. However, many current investors face more than one year without profits, so they need a longer carry-back period in order to claim the LIHTCs. This would stimulate new investments immediately and discourage the sale of current portfolios in a weak market. In addition, investors in new projects should generally be permitted to carry back LIHTCs for five years at any time during the 10-year term of the LIHTCs. This policy would address the tax risk for most LIHTC investors. Extending the carry-back to five years would require legislation.

2. Regional banks could increase the flexibility of Community Reinvestment Act (CRA) policies concerning regional investments. Regional and local banks could greatly expand their LIHTC investments, but many of these banks need (and want) to invest with others through large regional or national funds. These large-scale investment funds offer safety, risk diversification, and efficiency, especially for relatively new and small-scale investors. However, current CRA policy guidance limits the recognition of investments made through regional and national multi-investor funds, thus undermining the effectiveness of the CRA to motivate such LIHTC investments. The CRA regulation itself does allow recognition for bank investments in a region that includes a bank’s local “assessment area.” However, supplemental inter-agency Q&A guidance (revised January 6, 2009) presents two obstacles.

First, Q&A §__.12(h)-6 limits credit for regional investments to banks that are already adequately addressing the community development needs of their major assessment areas. The CRA’s desire to prioritize local needs is valid. However, a bank with numerous assessment areas may not be certain at the time it needs to make an investment decision that a subsequent examination will conclude that the bank has met this requirement. For example, after hurricanes Katrina and Rita in 2005, the banking regulators issued special policies encouraging banks nationwide to invest in rebuilding the Gulf Coast. One bank considered investing in the redevelopment of public housing in New Orleans. After checking with its regulator, however, the bank decided not to invest because it was told it had not invested enough in another market—even though the supply of LIHTC capital in that other market already far exceeded demand. As a result, LIHTCs in Louisiana are going unused, even though thousands of units are ready to begin construction. It should be possible to find another standard to encourage banks to meet local needs without discouraging regional investments.

Second, Q&A §__.12(h)-7 gives bank examiners discretion to grant less CRA credit for investments in large regions. However, many funds require regions as large as
a quadrant of the country to be workable and efficient. Many banks are reluctant to invest in such funds because they will not know how much CRA credit they will get until they are examined perhaps a year or more later. A very large bank can avoid these obstacles and target its LIHTC investments to the locations where it will get the most CRA credit by investing directly or by enlisting LIHTC syndicators to set up a fund in which it is the sole investor. Ironically, these approaches divert money from the broader multi-investor funds that regional and local banks prefer. Adding sufficient flexibility should not require a statutory or regulatory change; the four federal banking regulators could jointly modify the Q&A guidance on the CRA.

3. Fannie Mae and Freddie Mac could guarantee LIHTC investments made by others. Because the future status of Fannie Mae and Freddie Mac is uncertain, it may not be practical for them to make new LIHTC investments for their own portfolios. However, they could use their considerable expertise to help restore the LIHTC investment market by guaranteeing investments made by others, including both banks and other less experienced corporate investors. In past years, other financial companies have provided such guarantees but are no longer in a position to do so. Guaranteeing LIHTC investments would provide a source of profit to the GSEs and credit risk protection for investors. The GSEs might also attract new investors by dividing what is normally a 15- to 17-year investment into shorter segments. The Federal Housing Finance Agency, which oversees Fannie Mae and Freddie Mac as their conservator, could encourage and support this guarantee approach.

The LIHTC has been the linchpin in numerous successful public-private partnerships for over 20 years. As a public policy instrument, it has also helped to rehabilitate the reputation of federal housing production policies and was the model for the New Markets Tax Credit program and other policy innovations.

Problems with home mortgages and commercial real estate have created a financial crisis and touched off a deep recession. LIHTC investments continue to perform well economically, but the financial crisis has curtailed new investments. A few new policies could go a long way to restoring the LIHTC investment market and the housing, economic vitality, and partnerships that depend on it.

Additional Resources Provided for LIHTC Projects

The American Recovery and Reinvestment Act (ARRA), approved by Congress in February, 2009, provides two resources to states to help start LIHTC projects that stalled because equity investments became less available.

HUD is administering $2.25 billion through the Tax Credit Assistance Program (TCAP), which provides grant funding for capital investment in LIHTC projects to state housing credit allocation agencies. See Table 1 for 12th District state allocations. More information about the TCAP can be found at www.hud.gov/recovery.

Table 1

<table>
<thead>
<tr>
<th>State Housing Finance Agency</th>
<th>TCAP Recovery Grant Amount</th>
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</thead>
<tbody>
<tr>
<td>Alaska</td>
<td>$5,490,631</td>
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<tr>
<td>Arizona</td>
<td>$32,308,066</td>
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<tr>
<td>California</td>
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<td>Hawaii</td>
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<td>Idaho</td>
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<td>Oregon</td>
<td>$27,343,971</td>
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<td>Utah</td>
<td>$11,639,074</td>
</tr>
<tr>
<td>Washington</td>
<td>$43,010,192</td>
</tr>
</tbody>
</table>

Source: Department of Housing and Urban Development

In addition, each state can convert into cash a portion of the LIHTC authority the Treasury Department allocates by formula. Each state can exchange up to 40 percent of its 2009 allocation and 100 percent of its unused 2008 allocation. States would use the HUD funds and cash received in exchange for LIHTC authority to fund housing development projects that meet LIHTC requirements. For further information, go to http://www.treas.gov/recovery/LIH-grants.shtml.
Strength in Adversity: Community Capital Faces Up to the Economic Crisis

1. This article is a condensed excerpt of a Community Development Investment Center Working Paper, entitled “The Economic Crisis and Community Development Finance: An Industry Assessment.” For the full article by Nancy Andrews, see http://www.frbsf.org/publications/community/wpapers/2009/wp2009-05.pdf

2. Among the eleven interviews, six were with national or large regional CDFIs; two were rural CDFIs; and three were small and locally targeted CDFIs. Two were in the Midwest, three were headquartered on the West Coast, and six were headquartered on the East Coast.

Small Business Financing and Personal Assets


5. Avery, Bostic, Samolyk, p. 1052.

6. Ibid, p. 1052


Strengthening the Low Income Housing Tax Credit Investment Market

1. This article appears in Cascade No. 72, Fall 2009, a publication of the Community Affairs Department of the Federal Reserve Bank of Philadelphia.

2. Source: National Council of State Housing Agencies


Moving beyond Mission: Effectively Funding the Nonprofit Organization


5. Ibid.


12. Ibid.


Peer-to-Peer Lending and Community Development Finance

1. This article is a condensed version of the working paper entitled “Peer to Peer Lending and Community Development Finance.” The full article can be downloaded from http://www.frbsf.org/publications/community/wpapers/2009/wp2009-06.pdf.

2. Interview with Prosper CEO Chris Larsen on July 23, 2009. Source: Celent, a research and consulting firm focused on the application of information technology in the global financial services industry.


5. To date, only one platform, MicroPlace, has been granted approval from the Securities and Exchange Commission (SEC) to sell third-party-issued securities to multiple individual investors on its site without triggering a suitability requirement. While this is a key regulatory achievement, it is important to note that securities sold on MicroPlace are backed by their issuer—not the lender or the end borrower. The SEC has yet to allow any P2P finance platforms to sell third-party-issued securities backed by assets (loans) online.


7. Interview with Chris Larsen on July 17, 2009.