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THANK YOU SIR, MAY I HAVE ANOTHER: THE ISSUE OF THE UNSUSTAINABILITY OF LOW INCOME HOUSING TAX CREDITS AND PROPOSED SOLUTIONS

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I. Introduction

The Federal Low-Income Housing Tax Credit (LIHTC) program is currently the nation's largest federal subsidy for the development and rehabilitation of affordable housing,[1] having created or preserved over 2.5 million housing units and distributed over $7.5 billion in federal tax credits to developers of and investors in affordable housing from the program's inception in 1986 through 2007.[2] However, despite its monumental size and impact, the program has some potentially fatal flaws that threaten the long-term financial and physical viability of the very affordable housing that it creates, and threatens the health of the neighborhoods that it is created in.[3] Affordable housing projects built today are routinely constructed in communities that are already geographically segregated, overburdened with debt due to unnecessarily high up-front development fees and other debts, and simultaneously limited in the amount of rental income they can generate.[4]

In many ways, these building practices do not benefit the communities they are built in, and can lead to an unsustainable economic situation where the project's ability to fund its ongoing maintenance and capital improvements (new roofs, systems, etc.) are put in serious jeopardy because most of its revenue goes towards paying its operating

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1. Megan Ballard, *Profiting from Poverty: The Competition Between For-Profit and Nonprofit Developers for Low Income Housing Tax Credits*, 55 HASTINGS L.J. 211, 212 (2003).
2. NAT'L COUNCIL OF STATE HOUSING AGENCIES, STATE HFA FACTBOOK: 2010 NCSHA ANNUAL SURVEY RESULTS 92, 100 (2012).
3. *See infra* Part IV.
4. *See* Barry Zigas, *Learning from the Low Income Housing Tax Credit: Building a New Social Investment Model*, 9 CMTY. DEV. INV. REV. 47, 54 (2013). Zigas states that "there is considerable value "leakage" caused by layers of sponsors, syndicators, lawyers, accountants, and others needed to create, track, and document the credit." *Id.*

expenses and pre-existing debt.[5] Remarkably the state-run system of administering the LIHTC and the federal tax credit statute itself, allows, and in some ways, indirectly encourages developers to construct affordable housing projects in already segregated communities.[6] Furthermore, while these projects have a good shot at short-term profitability for the developers, they have a slim chance of being able to financially support themselves in the long-term – much to the detriment of the tenants who live there and the communities in which the projects are located.[7]

This article will focus on the issues that arise in the administration of the LIHTC in the State of Maryland. Part II of this paper will review the history of the LIHTC program and identify the defining features of the program – some of which are at the heart of the program's problems.[8] Part III will identify how this program works in Maryland – from its state-specific requirements to its application and administration.[9] Part IV will address some of the problematic issues in the LIHTC program: how the allocation of the tax credits has not alleviated geographic segregation, and how some of the program's key features have been misapplied by both private developers and governmental interests to the point that the program's central mission is no longer being adequately fulfilled.[10] Finally, Part V will offer some suggestions for ways to improve the long-term financial prospects of the affordable housing constructed under the program, including private/non-profit and private/governmental partnerships that will strengthen the program.[11]

Like most federal government programs, the Low-Income Housing Tax Credit program has gone through a full maturation cycle in the years since its inception, and looks much different today than it did when it was created almost thirty years ago.[12] In order to find out where the program should be headed, it is first necessary to see from where it came.

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5. *See infra* Part IV.B-C.
6. *See* The Low Income Housing Tax Credit, 26 U.S.C. § 42 (2006); *Md. Qualified Allocation Plan for the Allocation of Fed. Low Income Housing Tax Credits*, Md. Dept. of Housing and Cmty. Dev. (Jul. 8, 2014), http://www.dhcd.maryland.gov/Website/programs/rhf/Documents/MD_QAP_July_8_2014.pdf [hereinafter QAP].
7. *See infra* Part IV.
8. *See infra* Part II.
9. *See infra* Part III.
10. *See infra* Part IV.
11. *See infra* Part V.
12. *See generally* William H. Simon, *The Community Economic Development Model*, 2002 Wis. L. Rev. 377, 396-98 (2002) (discussing the evolution of the federal Urban Renewal program, Community Action Program, and the rise of state-run Public Housing Authorities).

II. The History and Purpose of the LIHTC Program

Federal and state governments have "been in the business of providing subsidized rental housing since the mid-1930's."[13] Government has used a multitude of programs to address housing affordability issues over the last century, from directly providing affordable housing with the public housing programs of the 1930's-60's,[14] to direct renter subsidies with the Section 8 rental assistance program in the 1970's.[15] In the mid-1980's, Congress turned to private housing developers to facilitate the creation of affordable housing when it enacted the LIHTC program as part of the comprehensive Tax Reform Act of 1986.[16]

The LIHTC program has somewhat loose requirements at the federal level; because the hallmark of the program is that it is to be administered by state housing agencies.[17] "The federal government allocates LIHTC program credits annually to each state based on population,"[18] and administers the distribution of the credits through the Treasury Department.[19] In 2010, the federal government made available $2.10 per capita worth of tax credits for each state, totaling $12 million available to Maryland.[20]

The tax credits are distributed as a whole to state "allocating agencies" (which usually are states' housing finance agencies), leaving the decision about how to specifically distribute the tax credits to the individual states.[21] Each designated state allocating agency must create and act pursuant to a Qualified Allocation Plan (QAP) that is used to distribute the tax credits, giving preference to projects serving the lowest income tenants.[22] The QAP creates an orderly method by which

13. Ballard, *supra* note 1, at 212.
14. *See* Zigas, *supra* note 4, at 48.
15. *Id. See also* Housing and Community Development Act of 1974, 12 U.S.C. § 1706(e) (1974) (current version at 42 U.S.C. § 1437(f) (2014)).
16. Tax Reform Act of 1986, Pub. L. No. 99-514, § 252, 101 Stat. 2189 (1986) (current version at 26 U.S.C. § 42).
17. 26 U.S.C. § 42.
18. Kimberly C. Moore, *The Federal Low-Income Housing Tax Credit Program: 25 Years of Public-Private Partnerships*, PERSPECTIVES ON REAL ESTATE NEWSLETTER (Pillsbury Winthrop Shaw Pittman LLP), Summer (2011).
19. Myron Orfield, *Racial Integration and Community Revitalization: Applying the Fair Housing Act to the Low-Income Housing Tax Credit Program*, 58 VAND. L. REV. 1747, 1777 (2005).
20. Rev. Proc. 2009-50, 2009-2 C.D. 617. In 2010, Maryland distributed over $9 million to ten affordable housing projects. *See 2010 Recipient List*, MD. DEPT. OF HOUS. & CMTY. DEV., http://dhcd.maryland.gov/Website/programs/lihtc/Default.aspx (last visited Oct. 20, 2013).
21. Marc Smith & Anne Williamson, *The Low Income Housing Tax Credit and Inner-City Revitalization*, 35 HOUS. & SOC'Y 129, 131 (2008). "The LIHTC program requires substantial state or local government action." Florence Wagman Roisman, *Mandates Unsatisfied: The Low Income Housing Tax Credit Program and the Civil Rights Laws*, 52 U. MIAMI L. REV. 1011, 1014 (1997).
22. 26 U.S.C. § 42 (m)(1)(A)(ii).

developers can submit applications and ultimately compete for the tax credits by articulating the selection criteria by which projects are chosen and the procedure used to monitor ongoing compliance with the program's requirements.[23] This allows states to use the federal tax credits to create and implement policies that directly address a state's specific housing needs, all with minimal federal interference.[24]

Most of the specifics of how the LIHTC program works are determined at the state level. The next section explains how the LIHTC program is administered at the state level in Maryland, why it is so desirable for developers, and how it facilitates the creation of affordable housing.

III. How the LIHTC Program Works

A. *How Tax Credits Fund the Development of Affordable Housing*

LIHTCs are essentially a development trade-off: a public subsidy that can be applied directly to the building costs of a project in exchange for a dedicated amount of affordable housing units in that project.[25] The affordable units are then rent-restricted and subject to income limitations that ensure low-income tenants have the opportunity to live in these units.[26] These tax credits "attract capital to an investment that is otherwise not attractive or economically desirable," and allow for affordable housing to be built even if the project's finances are tight.[27]

The main benefit of the tax credit program to developers is that there is a ready market of investors that are familiar with the product and willing to purchase credits, resulting in substantially lower permanent debt on projects than otherwise could be achieved. The state can issue tax credits to a project developer with an annual value of up to nine percent of the total cost of the development project, excluding the land costs, which is available to investors over a period of ten years, totaling 70 percent of the total qualified basis of the building.[28] The qualified basis of the building is the total development cost of that portion of the building that will qualify for LIHTCs, including developer fees, but minus land costs.[29]

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23. *Id.*
24. *See* Smith & Williamson, *supra* note 21, at 131.
25. Roisman, *supra* note 21, at 1014.
26. *Id.*
27. Zigas, *supra* note 4, at 50.
28. *See* 26 U.S.C. § 42 (b)(1)(A); QAP, *supra* note 6, at 2; Zigas, *supra* note 4, at 49.
29. MD. DEPT. OF HOUS. & CMTY. DEV., MULTIFAMILY RENTAL FIN. PROGRAM GUIDE: ATTACHMENT TO MD. QUALIFIED ALLOCATION PLAN FOR THE ALLOCATION OF FEDERAL LOW INCOME HOUSING TAX CREDITS 32 (2013) [hereinafter Program Guide].

For federal income tax purposes, LIHTCs are used to offset the taxes that for-profit taxpayers would otherwise owe on unrelated earned income, "dollar for dollar" and are not mere "deductions" from gross income.[30] Developers "sell" such credits by permitting for-profit taxpayers, usually corporations, to become investor/owners in the entity that owns a LIHTC-eligible project in return for a much-needed cash infusion of capital into that entity that can help to make a financially difficult project possible.[31] Once the project is completed the "tax credits begin to flow to the investors who purchased them."[32]

The main benefit of the tax credit to the public is that it requires a developer to dedicate a set amount of rent-restricted units per project for tenants who meet certain low-income requirements.[33] Federal law requires specific income limits for the set-aside units: either 20 percent of the total units in a project must be occupied by tenants earning 50 percent or less of the Area Median Income (AMI) (known as a 20/50 split) or at least 40 percent of the units must be occupied by tenants earning 60 percent or less of the AMI (known as a 40/60 split).[34] The rents for the units are established by the United States Department of Housing and Urban Development (HUD) annually, based on the number of bedrooms in a unit, and may not exceed 30 percent of the income ceiling.[35] A developer must commit to maintaining compliance with these rent restrictions for a minimum of 30 years (subject to earlier termination as discussed later in this article), although states are allowed to dictate longer terms.[36] The United States Internal Revenue Code (the Code) requires that each project's affordability restrictions be recorded in an "extended low-income housing commitment" (often called a "Land Use Restriction Agreement").[37] Currently, Maryland requires an additional 10 years of rent restrictions, for a total of forty years, but permits an owner to opt-out of the program restrictions after 15 years if there is a buyer willing to pay an above market-rate purchase price that *must be approved* by the Department of Housing and Community Development (DHCD).[38] In practice, this provision effectively prevents any project from leaving the program after 15 years.

30. Roisman, *supra* note 21, at 1014-15.
31. *Id.*
32. Ballard, *supra* note 1, at 219.
33. Nathaniel Baum-Snow & Justin Marion, *The Effects of Low Income Housing Tax Credit Developments on Neighborhoods*, 93 J. OF PUB. ECON. 654, 660 (2009).
34. 26 U.S.C. § 42 (g)(1)-(2).
35. See QAP, *supra* note 6, at 2.
36. Orfield, *supra* note 19, at 1777.
37. Zigas, *supra* note 4, at 51.
38. See QAP, *supra* note 6, at 2.

B. The QAP: How Tax Credits are Administered by the State

The creation of the QAP is a multi-step process where private interests, elected officials, and members of the public help to shape Maryland's procedure for allocating LIHTC.[39] Each state is required to create a QAP,[40] which in Maryland is created by the DHCD, along with public input, and amended yearly as necessary, after an opportunity for public comment and a public hearing.[41] The final draft of the amended QAP is then submitted to the Governor for approval.[42] After the approval of the QAP, the DHCD, designated as the agency that distributes the tax credits, monitors ongoing compliance with the state and federal requirements of the program – most importantly that a particular project maintains the minimum required percentage of affordable units for the agreed upon period of time.[43]

The QAP is used to promulgate the housing priorities that the state deems appropriate from time to time, be it elderly housing, housing for people with disabilities, or low-income family housing.[44] The QAP does this by outlining the process and procedures by which the DHCD will choose among all the competing development proposals, both by articulating the minimum requirements that all applicants must meet, including "site requirements, developer experience, and other measures of project quality" and by giving higher priority to various elements of the development process.[45]

This is done by constructing a ratings system that allocates various numbers of points to elements of the development process, project location, project design and services proposed to be delivered to residents, and awarding LIHTCs to those proposals with the highest number of points. This approach allows the state a large amount of flexibility to use the federal tax credits to address its specific housing issues, because it can make state housing policy objectives the threshold standards to meet when developers compete for the tax credits.[46] However, the process of formulating the QAP's standards by the DHCD can also be ripe for "backroom dealing," developer lobbying, and political intrigue that favor certain projects or policies over others.[47]

39. Roisman, *supra* note 21, at 1014; QAP, *supra* note 6, at 3.
40. 26 U.S.C. § 42 (m)(1)(A)(i).
41. *See* QAP, *supra* note 6, at 3. The DHCD gives at least 14 days notice to the public that a public hearing will be held, and accepts public comments in writing up until the date of the hearing. *Id.*
42. *Id.*
43. See *supra* text accompanying notes 33-37.
44. Zigas, *supra* note 4, at 52.
45. Smith & Williamson, *supra* note 21, at 133.
46. *Id.*
47. *See infra* Part IV. "For-profit developers. . .may also succeed in altering state-imposed preferences or set-asides in QAPs." Ballard, *supra* note 1, at 241-42.

For example, politicians may find that their constituents have a need for more elderly housing or for more housing for persons with disabilities, and can request that the DHCD make those particular housing needs a priority in the next QAP, which can give a developer who pledges to build that particular type of housing a competitive edge in the ranking process over developers who apply to build family housing. Or an interest group, like the construction industry, can lobby for more priority to be given to new construction projects over the rehabilitation of existing buildings, because new construction may be more profitable for builders. In both of these situations, "the annual development of the QAP is a crucially important advocacy opportunity" that can shape who benefits from the allocation of the year's supply of LIHTCs.[48] Since the QAP sets the rules by which all competitors must play, the yearly review and amendment process of the QAP is a prime opportunity for many interest groups to help shape how, and to whom, the next year's allotment of tax credits are distributed.[49] One way this is done is by influencing what criteria are included in the QAP, and the number of points associated with each "Competitive Scoring Criteria."[50]

The QAP scores each project application according to certain criteria, where each criterion has a certain point value assigned to it, with a maximum total score of 200 points.[51] The DHCD then ranks the proposed projects based on the overall score of the application, and distributes the tax credits to the highest scoring projects.[52] One important criterion is the physical location of the proposed development.[53] The location of affordable housing developments can help further a state's mission to deconcentrate poverty, improve urban housing stock, or jump-start economic development in a targeted area.[54] Two "priority project categories" in Maryland are "Family Housing in Communities of Opportunity" (Communities of Opportunity) and "Community Revitalization and Investment Areas" (Revitalization Areas).[55]

A project receives a large amount of the total points allotted to the location of a proposed development by building their housing in a Community of Opportunity zone, i.e. a suburban area, or a Revitalization Area, i.e. a depressed urban area. Communities of Opportunity are described by the QAP as having good schools, high homeowner-

48. Florence Wagman Roisman, *Poverty, Discrimination, and the Low-Income Housing Tax Credit Program*, IND. UNIV. ROBERT H. MCKINNEY SCH. OF LAW (Nov. 2000), http://mckinneylaw.iu.edu/instructors/roisman/lihtcmemo.pdf.
49. *Id.*
50. *See* Program Guide, *supra* note 29, at 47.
51. *See infra* Appendix.
52. *See infra* Appendix.
53. *See* Program Guide, *supra* note 29, at 56.
54. Smith & Williamson, *supra* note 21, at 133.
55. Program Guide, *supra* note 29, at 13.

ship rates, low poverty rates, low property vacancy rates, low unemployment rates, and school systems with high standardized test scores and graduation rates.[56] Generally, these suburban areas are less densely populated and have less dense zoning in many areas than their urban counterparts, although their land costs may be higher.

In contrast, Revitalization Areas are described by the QAP as being located within either a Qualified Census Tract or federally designated Difficult to Develop Area, which are both areas that have significant levels of poverty and other economic challenges.[57] A Qualified Census Tract is an area designated by the Secretary of HUD where, according to the most recent census data, 50 percent or more of the households have an income less than 60 percent of the AMI, or an area that has at least a 25 percent poverty rate.[58] Generally, these urban areas have much higher concentrations of minority residents than their suburban counterparts, and many times have underperforming school systems with low standardized test scores and graduation rates.[59] However, both Communities of Opportunity and Revitalization Areas come with their own development and social challenges, which is discussed in Part IV.A.

A project proportionally receives the largest amount of points based on the experience of its development team.[60] The determining factor is the financial viability of the development company and the company's track record during the previous five years with comparable housing projects.[61] This scoring criterion may reflect the desire of the DHCD to have stable development partners, but it may also stifle new companies who are unable to compete with the financial strength and performance of a few favored developers. However, given the relative complexity of successfully competing for the LIHTC and properly renting up and managing those projects after completion, "successful developers are those with experience and the capital to be able to withstand lengthy application review periods and compliance monitoring requirements."[62]

The QAP has general requirements concerning the services a project should provide its residents, but it does not articulate how those services should be delivered. It mandates that projects funded in Ma-

56. *Id.* at 14-16.
57. *Id.* at 16; 26 U.S.C. § 42 (d)(5)(B).
58. Philip Tegeler, Megan Haberle, & Ebony Gayles, *Affirmatively Furthering Fair Housing in HUD Housing Programs: A First Term Report Card,* 22 J. Affordable Housing & Cmty. Dev. L. 27, 59 (2013) (citing 26 U.S.C. § 42(d)(5)(B)(ii)).
59. Seema Ramesh Shah, *Having Low Income Tax Credit Qualified Allocation Plans Take Into Account the Quality of Schools at Proposed Family Housing Sites: A Partial Answer to the Residential Segregation Dilemma?,* 39 Ind. L. Rev. 691, 711 (2006).
60. *See* Program Guide, *supra* note 29, at 50.
61. *Id.*
62. Smith & Williamson, *supra* note 21, at 134.

ryland must provide services "appropriate to the population served by the project," which is reinforced by specific scoring criteria.[63] Obviously, elderly and special-needs housing requires some specialized services which can raise the overall operating cost of the project, but even family projects must provide "passive links to appropriate community services for tenants" that will improve the "residents' ability to uphold their lease obligations" and "enhance the quality of life."[64]

Typical community services include on-site debt counseling, job training programs, child care, food programs, and supplementary transportation (a bus that connects the property to a local transportation hub). However, no charge can be imposed on residents for these services, which create extra operating costs for the projects and can lead to increasing financial distress and the potential for default on the project's debt.

Finally, substantial fees may be included in the total development cost of the project: fees for developers, architects, contractors, lawyers, and more. These fees may only be paid from equity or cash flow from the property itself.[65] The project developer usually has his fee disbursed over the a period of several years, depending on the limitations imposed by LIHTC investors: i.e. 25 percent at the closing of the deal, 25 percent after "substantial completion," and the remaining 50 percent after the project is totally complete.[66] In many cases, construction cost overruns, slower than expected occupancy and/or conversion of construction to permanent loans at lower dollar amounts cause some portion of the development fee to be unpaid at completion and paid from project cashflow over time thereafter. Part IV will discuss the issues of how key aspects of the program's scoring criteria encourages developers to build in already poor areas instead of spreading the projects out across a region, and how a high developer's fee can be a primary threat to the long-term financial viability of a project where it effectively eats up any additional operating income that could be saved for capital improvements.[67]

IV. Problems With the Program

A. *The Overdevelopment of "Revitalization Areas" has led to Increased Geographic Segregation*

The way the QAP is currently written financially entices developers to build 100 percent low-income housing in already poor, urban neighborhoods, which exacerbates the existing geographic segregation in those neighborhoods. Many developers find that urban areas

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63. *See* Program Guide, *supra* note 29, at 26.
64. *Id.* at 26-27.
65. *Id.* at 83.
66. *See id.* at 83.
67. *See infra* Part IV.

are lucrative locations in which to build, evidenced by the fact that over 50 percent of all tax credit properties are built in such areas.[68] There are usually lower land costs, and the QAP also builds in a pretty substantial incentive: a project built in a Qualified Census Tract is eligible to receive a 30 percent bonus in their qualified basis.[69] This means that if a project qualifies for the "basis boost," the total LIHTC-eligible costs of the project are *deemed* to be increased by 30 percent for the purposes of allocating the LIHTCs, thereby resulting in 30% additional tax credits on which cash can be raised.[70] A side effect of the "basis boost" is the increased financial attractiveness of urban areas as the building site of choice for LIHTC projects, which continues to perpetuate racial and economic segregation in these areas.[71]

Land costs can be higher in suburban areas, and it can be difficult to find a piece of property suitable to building a multifamily project since much of the land either must be rezoned for multi-family housing or is not convenient to public transportation. Furthermore, the QAP includes a provision where a developer must seek local community approval for a proposed tax credit project or risk the rejection of its application by the DHCD.[72] This allows community groups opposed to the development of affordable housing in their neighborhood to frustrate the creation of that housing.[73] While the power to veto a proposed development is available to communities in both urban and suburban areas, communities in suburban areas are typically the ones that oppose the expansion of affordable housing in their neighborhoods.[74] "These [local approval] provisions. . .lead to a concentration of such housing in areas with higher poverty levels."[75]

Additionally, although federal law requires a minimum percentage of the units in each project be occupied by persons with certain maximum income limits for the set-aside units (i.e., the 20/50 or 40/60

68. *See* Roisman, *supra* note 21, at 1020.
69. *See* QAP, *supra* note 6, at 10; Karen Horn & Katherine O'Regan, *The Low Income Housing Tax Credit and Racial Segregation*, FURMAN CTR. FOR REAL ESTATE & URBAN POLICY (May 2, 2011), http://furmancenter.org/files/publications/LIHTC_Analysis_Racial_Segregation_Final_all.pdf.
70. *See supra* note 28 and accompanying text.
71. *See* Shah, *supra* note 59, at 712-13.
72. *See* Program Guide, *supra* note 29, at 7.
73. *See id.* "[W]hen residents engage in 'NIMBYism,' local officials will likely follow suit." J. William Callison, *Achieving Our Country: Geographic Desegregation and the Low-Income Housing Tax Credit*, 19 S. CALIF. REV. OF L. & JUSTICE 213, 256 (2010).
74. *See* Alison Knezevich, *Baltimore County Council Rejects Low-Income Housing Project*, BALTIMORE SUN (Nov. 18, 2013), http://articles.baltimoresun.com/2013-11-18/news/bs-md-co-housing-vote-20131118_1_housing-project-affordable-housing-baltimore-county-council (stating that community concern about the creation of additional affordable housing, with some residents receiving Section 8 vouchers, would increase crime and lower property values).
75. Callison, *supra* note 73, at 257.

split), a project gets additional points for going beyond that minimum by having an even larger proportion of its units be LIHTC eligible.[76] This is in part due to the wording of the Code itself, which states "each QAP must give preference to projects serving the lowest income tenants for the longest periods of time."[77] It is not unusual to have entire developments comprised solely of affordable rent-restricted units.[78] Whereas the program contemplates a potential for mixed-income housing developments with somewhere between 20 and 40 percent of the units designated as affordable, and the rest unrestricted as to incomes and rents, this is hardly ever the case in reality, due to the competitiveness of yearly tax credit allocation process, where more points are awarded for projects with higher percentages of LIHTC-eligible units.[79]

This results in the majority of projects in Maryland consisting of 100 percent affordable housing, turning tax credit developments into *de facto* public housing for the working poor (i.e., those with incomes that are sufficiently high to pay the below-market rents, but not so high as to exceed the applicable percentage of AMI, or who use a Section 8 housing voucher to pay the rent). The QAP also dictates that LIHTC projects must establish a priority for households on the waiting list for Section 8 assistance, and must make effort to refer potential priority households to the project, which has the potential effect of causing more persons with little to no income to live at the projects and to frustrate economic integration.[80]

Only recently has federal law begun requiring the collection of demographic information on the tenants being served by tax credit developments. The Housing and Economic Recovery Act of 2008 requires that properties that receive LIHTCs provide HUD, and HUD must make publicly available, "data regarding the race, ethnicity, family composition, age, income use of rental assistance, disability status, and monthly rental payments" of all residents.[81] The hope was that this data would allow HUD to evaluate the "integrative success of LIHTC siting" in order to determine whether these projects either "perpetuate segregation or affirmatively further fair housing."[82] However, Congress has not yet appropriated money for the collection of

76. *See* Program Guide, *supra* note 29, at 62.
77. 26 U.S.C. § 42(m)(1)(B)(ii).
78. *See* Baum-Snow & Marion, *supra* note 33, at 660. ("Since the program's inception, over 95 percent of units in projects supported by the program qualified as low income.").
79. *See* Program Guide, *supra* note 29, at 61 ("DHCD will award points for income targeting in excess of these minimum requirements.").
80. *Id.* at 24.
81. Tegeler et al., *supra* note 58, at 58.
82. *Id.*

this data, and as of 2013, many states, including Maryland, have not made this data available to HUD or to the public.[83]

B. The Developer's Fee Payment Structure Gives No Incentive to Developers to Continually Invest in the Properties

Most developers of tax credit properties are for-profit entities.[84] As Professor Ballard discusses, "For-profit developers of affordable housing grapple with a potential contradiction: On the one hand, a for-profit entity exists in order to create a profit. On the other hand, a for-profit developer. . .is charged with providing housing for poor people who likely cannot afford to help for-profit developers generate excess income."[85] The tension between profit and stewardship is exacerbated by QAP provisions that allow a developer to be paid their full fee during the beginning years of a project's lifespan.

One of the biggest strengths of the program is also one of its biggest weaknesses: providing units to the lowest income tenants at LIHTC-restricted rent levels does not allow the property to raise rents to cover growing expenses and capital needs as a property ages. Furthermore, in order to cover the debt service of a property, there is an incentive to keep rents a high as statutorily allowed while still complying with the maximum individual requirement of 30 percent of 60 percent of the AMI, which does not further the federal goal of providing housing that serves the lowest income tenants.[86] This tension is palpable in for-profit tax credit deals, for "the program strives to house poor people, but no one so poor that they cannot pay rents sufficient to preserve a profit for the developers."[87] This effectively means creating a floor on the amount of income that a qualifying person must have in order to pay rent (i.e., the industry standard of 2 ½ to 3 times the amount of rent, and leaves a whole group of people squeezed between the sides – too well off for public housing, yet too poor to pay for affordable units that were created to house them).

Furthermore, the way that development fees get paid does not mirror the sort of commitment to affordable housing that the federal LIHTC program contemplates.[88] The QAP allows property developers to include a maximum of a $2.5 million development fee in the original financial structure of an affordable housing deal, thereby drastically increasing the amount of debt on a property while also increasing the LIHTC-eligible basis of the project.[89] Curiously, unlike the mortgage on a property (the repayment of which usually is spread

83. *Id.*
84. Ballard, *supra* note 1, at 212.
85. *Id.* at 233.
86. 26 U.S.C. § 42 (m)(1)(B)(ii)(I).
87. Ballard, *supra* note 1, at 233.
88. *See generally* 26 U.S.C. § 42 (2013).
89. Program Guide, *supra* note 29, at 36.

over a period of 20-30 years), or the investors' tax credit benefits (which are spread over a ten year period), the QAP allows a developer to withdraw the entire development fee once the construction of the property is completed – well before the property proves itself financially. Although the development fee may not be paid in full by this date, the QAP sets the wrong tone by not requiring that some portion of the development fee be paid during the same ten-year period that LIHTC benefits accrue to investors. The current fee-withdrawal schedule does not encourage any substantial accountability on the part of the developer to put together a deal whose finances are stable and realistic, and which will produce cash flow to support the inevitable physical demands of the building over time, because the developer's priority is to get paid on the front end, well before the realities of an under-funded property set in.

Furthermore, the QAP enables a developer to compromise a property's financial viability in other ways. For example, a project must maintain an operating reserve equivalent to three to six months of operating expenses and debt service payments, which effectively creates a cash-cushion for unforeseen expenses.[90] However, after one year, a developer can draw down the operating reserve to pay outstanding developer's fees, as long as the project continues to break-even during the three-year operating reserve release period.[91]

During the first few years of the project's lifespan, there is not a pressing need for the operating reserve because the physical condition of the property is still relatively new and requires little maintenance. Additionally, the QAP only mandates a replacement reserve of only $300 per unit per year. This frees up the initial cash flow to balance the finances of the property and, therefore, pay out the developer's fee.[92] When the property begins to require significant reinvestment, ten to 15 years into its life cycle in order to deal with aging systems such as windows, roofing, plumbing, kitchens, and baths, the $300 per unit per year replacement reserve may be inadequate to finance major capital expenditures, thereby leaving the property in a vulnerable position.

C. *The Maryland LIHTC Program's Focus on New Construction and 40-Year Affordability Restrictions Hurt the Ability of the Property to Remain Financially Healthy*

The structure of the QAP program encourages the development of new affordable housing, but it does not contain adequate provisions to preserve and maintain the physical condition of existing affordable housing over the term of the affordability restrictions. The poor fi-

90. *Id.* at 32.
91. *Id.*
92. *Id.*

nancial structure of an LIHTC property will eventually lead to less affordable housing, not more. Deferred maintenance will cause systemic occupancy issues in that property, in turn, causing the property to enter a financial tailspin, losing further rental income necessary to prevent further decline.

Although preservation of existing affordable housing is a stated priority of the QAP, in practice, the QAP favors new construction over the maintenance of pre-existing structures.[93] Only two points out of forty-six total points are allotted to the preservation of existing affordable housing in the project Scoring Summary Table, highlighting the low priority the QAP puts on maintaining existing housing on which affordability restrictions already exist.[94] It is unlikely that an existing affordable housing property would qualify for financing over a proposal for new construction. This effectively cuts off a necessary source of funding for affordable housing properties.

Furthermore, Maryland's forty-year affordability restrictions may frustrate a property owner's ability to obtain conventional refinancing for better interest rates or renovations to the property, both because the dearth of cash available to maintain the property has resulted in its costly physical deterioration and deferred maintenance, and the permitted LIHTC rents are restricted as to future increases by HUD and are not reflective of market rents.[95] Therefore, there is no assurance of increased potential income for the property owner to borrow against, both because the property's rents cannot increase, even if it underwent a substantial rehabilitation (as opposed to the private market), and because HUD is not obligated to increase LIHTC rents.[96] This effectively forces the property owner to rely on a limited number of lenders that are willing to accept the inherent risks associated with LIHTC properties, or hope that future QAPs will give priority to funding existing LIHTC properties.

V. Suggestions for Ways to Improve the Program

A. Amend the Federal Tax Code and the Maryland QAP to Mandate Mixed-Income Developments in Order to Increase Racial and Economic Integration

The primary reason the Code granted individual states the independence to create their own QAPs was so each state could use the tax credits to further their own individual housing policies and goals.[97] To this end, Maryland's QAP should be amended to reflect the goal of

93. *See* Program Guide, *supra* note 29, at 17; Sagit Leviner, *Affordable Housing and the Role of the Low Income Housing Tax Credit: A Contemporary Assessment*, 57 TAX LAW. 869, 881 (2004).
94. *See* Program Guide, *supra* note 29, at 53.
95. *See* Ballard, *supra* note 1, at 235.
96. *See id.*
97. Smith & Williamson, *supra* note 21, at 133.

combating entrenched geographic segregation. In order to decrease the geographic segregation caused by LIHTC projects, the Code and Maryland's QAP must both be reformed in order to reflect more diverse siting and occupancy standards, which will allow LIHTC projects to further fair housing goals.

One reason tax credit developers typically avoid building in suburban areas is because the QAP does not offer the same financial incentives as urban areas (including lower land costs and the ability to be eligible for additional tax credits).[98] One way to combat this is to allow developers in suburban areas to include all or part of the land costs in their "eligible basis," thereby allowing them to receive some financial assistance with the higher land costs through the award of additional LIHTCs.[99] Another way to combat geographic segregation is to amend the QAP to require a proposed project be in close proximity to better-performing schools, which are included in the QAP's description of "Communities of Opportunity," i.e. suburban neighborhoods.[100]

The QAP's scoring criteria should also be amended to cap the proportion of affordable units in a project at fifty percent in order to ensure that each project constructed has the chance to be a vibrant, mixed-income community.[101] By amending the Code's provision and by removing the QAP's bonus points awarded to a project exceeding traditional affordability proportions (i.e. the 40/60 split), Maryland can encourage economic desegregation with each new project built.[102]

Additionally, multiple academics advocate that since the tax credits are originated by the Treasury Department, the Treasury should take a more active role in ensuring the distribution of LIHTCs "affirmatively furthers" fair housing.[103] This would give the individual states an additional layer of accountability when amending their QAPs to reflect the priority of geographic desegregation. In order for the Treasury to act, it first needs to affirmatively enforce the provisions in the Housing and Economic Recovery Act of 2008 that mandates the collection of demographic data from each project receiving LIHTCs.[104] This would allow the Treasury to create a map of all existing LIHTC projects and require the DHCD to assess how each new

98. *See supra* notes 68-70 and accompanying text.

99. *See supra* notes 28-29 and accompanying text.

100. Callison, *supra* note 73, at 255.

101. *See supra* note 79 and accompanying text; Program Guide, *supra* note 29, at 61.

102. *See* 26 U.S.C. § 42 (m)(1)(A)(ii); Program Guide, *supra* note 29, at 61.

103. *See* Callison, *supra* note 73, at 254; Orfield, *supra* note 19, at 1777; Roisman, *supra* note 21, at 1042; Tegeler et al., *supra* note 58, at 60.

104. Tegeler et al., *supra* note 58, at 58.

project proposal would affect the demographics in its proposed location.[105]

B. Disburse the Developer's Fee Over a Longer Period of Time so as to Create Incentive to Continually Invest in the Properties

It is simple to give academic suggestions for how to fix a complicated housing finance program, but that seldom leads to practical solutions.

This paper suggests the following measures in order to solve the problem of a developer's fee draining the coffers of a property before the foreseeable physical needs of the property have been cared for:

1) At least 25% of the developer's fee should be paid during the ten year LIHTC period only from cash flow[106] in excess of the amount needed to fund 120% of property debt service – longer than the "break-even" period required by the Program Guide.[107]

2) Replacement reserves for each property should be increased at an annual rate (i.e. 5%) sufficient to build up adequate reserves for each property when needed in years 11-20.

3) The guarantor of LIHTC compliance during the first fifteen years should be required to liquefy some portion of its funding obligation (i.e. 25%) with cash or a letter of credit, which would give it incentive to cause the project to be constructed with more durable building materials and to monitor maintenance of the project in order to protect against poor marketability of units due to their deteriorated condition.

These changes would most likely narrow down the list of developers willing to take part in LIHTC projects, but since the yearly LIHTC allocation competition in Maryland always has more competitors than available credits, this is a risk worth taking that could be successfully mitigated.[108]

C. Create a Framework Where For-Profit and Non-Profit Developers can own and Operate an Affordable Housing Property in Stages, so that the Property is Ensured Proper Maintenance Over Time

For-profit developers are in this business to make a profit, and providing affordable housing just happens to be the vehicle to accom-

105. Roisman, *supra* note 21, at 1042.
106. The Program Guide defines cashflow as property net revenues after payment of all operating expenses and funding all required reserves. *See* Program Guide, *supra* note 29, at 56.
107. Program Guide, *supra* note 29, at 31.
108. *See 2012 Multifamily Housing Notice 12-12*, Md. Dept. of Housing and Cmty. Dev., http://dhcd.maryland.gov/Website/programs/rhf/notices/notice_12_12.pdf (last visited Oct. 20, 2013). DHCD received 21 applications and granted 13 of them in 2012, and in 2011 they received 29 applications for LIHTC projects. *Id.*

plish that goal.[109] On the other hand, non-profit developers are often "mission-driven to provide affordable housing" and often have long-term success managing LIHTC developments years after the initial fees have been paid out.[110] However, studies have shown that for-profit developers are able to produce a LIHTC unit at a substantially lower initial cost than non-profit developers.[111]

The profit motive of the for-profit developer can be used as an asset instead of a liability to the long-term financial health of an affordable housing project. For-profit developers can get things built, and more importantly, many for-profit developers are vertically integrated.[112] One company has in-house architects, land developers, contractors, and lawyers – all of which can streamline the process and keep the prospective costs of a project down.[113] As a compliment to for-profit's efficiency, non-profits bring a different set of priorities to the table, priorities that match the long-term physical and financial needs of affordable housing projects.

The logical answer is some sort of cooperative effort: for-profit developers build the property, lease it up, and get it running, and non-profits step in at year ten to fifteen to purchase the property and run it for its duration (or longer).[114] This allows the for-profit entity to continue doing what they do best – developing housing – while non-profits can provide the sort of commitment and stability that these existing properties require in order to continue to financially perform.[115]

VI. Conclusion

Providing the right kind of affordable housing to millions of needy Americans is an important task, one that should be about more than generating profits. LIHTCs are important to many property developers, for they can be the difference between a project being built and

109. *See* Smith and Williamson, *supra* note 21, at 136 ("For-profit owners have a strong focus on the financial bottom line and aim for maximization of investment returns.").

110. *Id.*

111. Ballard, *supra* note 1, at 236. The General Accounting Office estimates that the average cost of one LIHTC unit built by a for-profit developer is about $18,000 less than one built by a non-profit developer. U.S. Gen. Acc. Off., Tax Credits: Reasons for Cost Differences in Housing Built by For-Profit and Non-Profit Developers 1 (1999).

112. *See* Moore, *supra* note 18, at 1.

113. *Id.*

114. Ballard, *supra* note 1, at 237. In contrast to most for-profit developers, non-profits traditionally maintain higher operating reserves to support sustained low-income use. *Id.*

115. Although non-profits have employees and costs, just like for-profits, their directors are limited in the amount of money that they can withdraw from the deal at one time (unlike for-profit developers), which typically limit the non-profit developer's inclination to leave a project financially strapped in order to increase personal profits.

not. Therefore, stricter distribution guidelines should be adopted by the state to reflect just what a powerful tool tax credits can be. If administered correctly, tax credits can be a real force for positive change in a community, and can serve to develop more than just one project; they can also serve to redevelop a community for generations to come.

Appendix:
Maryland Department of Housing and Community Development Multifamily Rental Financing Program Guide Page 53

Scoring Summary Table	Maximum Possible Points
5.1 Capacity of Development Team	**74 Total Points**
5.1.1 Development Team Experience	42 points
5.1.2 Deductions from Team Experience Score	- 10 points
5.1.3 Developer Financial Capacity	18 points
5.1.4 Nonprofits (NPs)	14 points
5.2 Community Context	**28 Total Points**
5.2.1 Community Impact Projects	16 points*
5.2.2 Communities of Opportunity	16 points*
5.2.3 Transit Oriented Development	8 points
5.2.4 Rehab of Existing Properties	4 points
5.3 Public Purpose	**46 Total Points**
5.3.1 Income Targeting	14 points
5.3.2 Targeted Populations: Non-Elderly PWD or Special Needs	10 points
5.3.3 Family Housing	8 points
5.3.4 Tenant Services	8 points
5.3.5 Mixed Income Housing	4 points
5.3.6 Preservation of Existing Affordable Housing	2 points
5.4 Leveraging and Cost-Effectiveness	**20 Total Points**
5.4.1 Direct Leveraging	10 points
5.4.2 Operating Subsidies	10 points
5.4.3 Construction or Rehabilitation Cost Incentives	- 8 points
5.5 Development Quality	**32 Total Points**
5.5.1 Green Features	12 points
5.5.2 Brownfields Redevelopment	1 point
5.5.3 Energy and Water Conservation	4 points
5.5.4 Site and Building Design	15 points
5.6 State Bonus Points (maximum of10 points)#	See note
Total	**200**

*Project cannot receive points under both Community Impact and Communities of Opportunity categories.
#State Bonus Points may be awarded outside of the 200 point scale