

**THE LOW INCOME HOUSING TAX CREDIT
A STUDY OF ITS IMPACT AT THE PROJECT LEVEL**

by

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ABSTRACT

As federal and state subsidies decreased in the past decade, the Low Income Housing Tax Credit (LIHTC) emerged as the primary method of financing affordable housing today. Developers acquire the credit from state allocating agencies and then sell them to investors in order to raise capital for low income housing projects. The investors benefit since they receive a dollar-for-dollar reduction in their tax liability as well as the ability to claim passive losses on their federal tax return.

The majority of the research conducted to date on the LIHTC program is undertaken from the point of view of the developer and investor. The goal of this thesis is to examine the LIHTC system from the project level specifically through the eyes of the property manager. To analyze how the complex LIHTC system, made up of many participants, influences the property manager's ability to effectively manage quality affordable housing. The environment in which the property manager operates is influenced by the LIHTC program and its participants, additional subsidies and their requirements as well as the housing market itself. These three components will be examined in order to study the impact of the LIHTC program on the project itself.

This thesis discusses the LIHTC at the national level to provide a general understanding of the program. Massachusetts projects and information are the primary focus to provide a specific context for the issues.

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CHAPTER ONE: INTRODUCTION

OVERVIEW

The 1949 National Housing Act promised to provide decent, safe housing for every American. Today one would find it debatable as to whether that promise is being upheld. In the last 15 years, the supply of market rate units has expanded while the stock of subsidized and otherwise affordable units has decreased.¹ At the same time, the number of poor renter households has increased. Between 1989 and 1991 this number went from 7.4 million to 8.2 million.²

Affordable housing policy has ranged over the years from the 1960's approach of "the federal government should be a major actor" to the 1980's view that "the federal government should get out of the housing business."³ Financing alternatives for affordable housing have followed suit, varying throughout the years from direct federal assistance to investment incentives programs. In the past decade, direct federal assistance programs through the department of Housing and Urban Development (HUD) have decreased. What has replaced them is the Low Income Housing Tax Credit (LIHTC), a dollar for dollar reduction in the tax liability that eligible investors can exchange for investment in designated rental housing.

Utilizing the American tax system to stimulate the nation's housing supply is not a new concept. Although the Internal Revenue Code (IRC) has altered the

¹Affordable and low income housing, for the sake of definition, refers to housing for low and moderate income households (i.e. households at and below the median income).

²Joint Center for Housing, Harvard University, *State of the Nation's Housing, 1992*, p. 17

³ Langley Keyes and Denise DiPasquale, *Housing Policy for the 1990's*, MIT Housing Policy Project, HP #0, MIT Center for Real Estate Development, (August 1988), p. 1.

provisions through the years, generally there have been tax benefits for the development of market rate and affordable housing. The 1986 Tax Reform Act (TRA 86) dramatically changed this scenario by eliminating most benefits for investing in and producing market rate rental housing. However, the TRA 86 established the LIHTC which emerged as the primary source of financing affordable housing today. In 1993 alone, it accounted for over 60% of *all* multifamily housing starts in the United States. (See Figure 2.1)

While the program is serving its objective in providing housing for low and moderate income households, it is the federal government's most complex housing program to date. Rather than have the federal government oversee the entire process, separate organizations and professional groups perform different roles in the process. As with most tax provisions, legal and financial counsel is required to best understand and utilize the program. Yet, accountants and lawyers comprise only a small portion of the numerous players involved in running the program. Other participants include the Internal Revenue Service (IRS), state allocating agencies, developers, syndicators, investors, property managers and compliance monitors. (See Figure 1.1)

At all levels of the process, many of the participants involved with the LIHTC have had a difficult time understanding its mechanics. In part, this can be explained by the age and tenuous existence of the program. When enacted in 1987, the initial term for the LIHTC was intended to be three years, though Congress prolonged it in three separate extensions. In 1992 the program was canceled and not reinstated on a permanent basis until August of 1993. Due to its uncertain future, many potential participants were unwilling to utilize the

program for fear of cancellation. Furthermore, investors were wary, given their ten-year time frame for obtaining the program's full benefit and the possibility that if the credit disappeared so did their tax benefit. They were reluctant to bet on the whims of Congress.

Now that the LIHTC is permanent, as it matures it is a prime candidate for analysis.⁴ The participants are becoming more involved, thereby increasing the competition for obtaining credits from the state allocating agencies. With the recession of the early 1990's ending, corporate investors can again think about their "tax appetite", thus creating a larger pool of available capital for affordable housing. This research supports the fact that the supply and demand of affordable housing is not in a state of equilibrium and therefore, the LIHTC, as a primary financing source, plays a significant role in the industry today.

SCOPE OF STUDY

To date, the majority of research on the LIHTC has examined the program from either the development or investor perspective. These roles occur primarily at the front end of the LIHTC process and with the stringent IRS guidelines establish the framework for the project. While these views are important, it is necessary to investigate the latter half of the LIHTC process in an attempt to evaluate the full impact of the program. The goal of this thesis is to analyze the three components of the LIHTC system from the project level, specifically through the eyes of the property manager.

⁴It should be noted that "permanent" here means that the LIHTC is no longer on a year to year extension existence. It is still subject to the whims of Congress in the sense that it could be rescinded several years hence in another tax reform act.

- The complex LIHTC program and its multiple players
- The additional subsidies and their requirements
- The housing market

These three factors all influence the property manager's ability to effectively manage quality affordable housing. The significance of the relationship among this trio is the effect on the project itself. The objective of the program is not just to develop housing, but a quality product that meets the needs of its clientele, low income tenants.

This thesis discusses the LIHTC at the national level in order to provide a general understanding of the program. However, case studies focusing primarily on Massachusetts information and projects are utilized in order to provide a specific context for the issues at hand. Since the inception of the LIHTC in 1987, Massachusetts has utilized over 80% of its allocated credits to construct and preserve low income dwellings. This high percentage is in contrast to many other states. Forty percent of the states have used less than 70% of their allocations. Over 50% of that number have historically distributed less than half of their allocations.⁵ Furthermore, Massachusetts has been at the forefront of supplying quality affordable housing in this country. It funnels \$40 per capita into housing and community development activities compared to the national average of \$2 per capita.⁶ Many of the LIHTC projects in the State are sponsored by Community Development Corporations (CDCs) and non-profit developers rather than for-profit developers. The two entities have different product types, the first of which

⁵Source: National Council of State Housing Agencies

⁶Eric S. Belsky, "The States and Housing Assistance," *Housing Economics*, Volume XXXXI, Number 5, (May 1993), p. 6.

provides an additional challenge in implementing the LIHTC program. As a State, it has proven itself a sophisticated player, thereby serving as an ideal setting for examining one of the primary methods of financing affordable housing today.

This thesis is presented in six chapters.

Chapter 2 provides an overview of multi-family rental housing in the United States. The market has never completely fulfilled the needs of low and moderate income households, thereby leaving a gap. The government has transformed its role in low income housing from a full-service provider to creating a market incentive via the tax system. The chapter briefly discusses the need for affordable housing as well as some prior methods of providing it, thereby establishing a context for the need of the LIHTC.

Chapter 3 discusses the role of the American tax system in providing both market rate and affordable housing. A brief history and origin of the LIHTC program is also presented.

Chapter 4 outlines the LIHTC program and then examines its impact on the participants in the process. The chapter commences with a review of the basic mechanics and then looks at the influence the state, in particular Massachusetts, has on the program. Following this review, "project players" enter. The developer, syndicator and investor all use the LIHTC to establish the framework for the project. The process up to this point creates a nest of issues which impinge on the manager and the project itself.

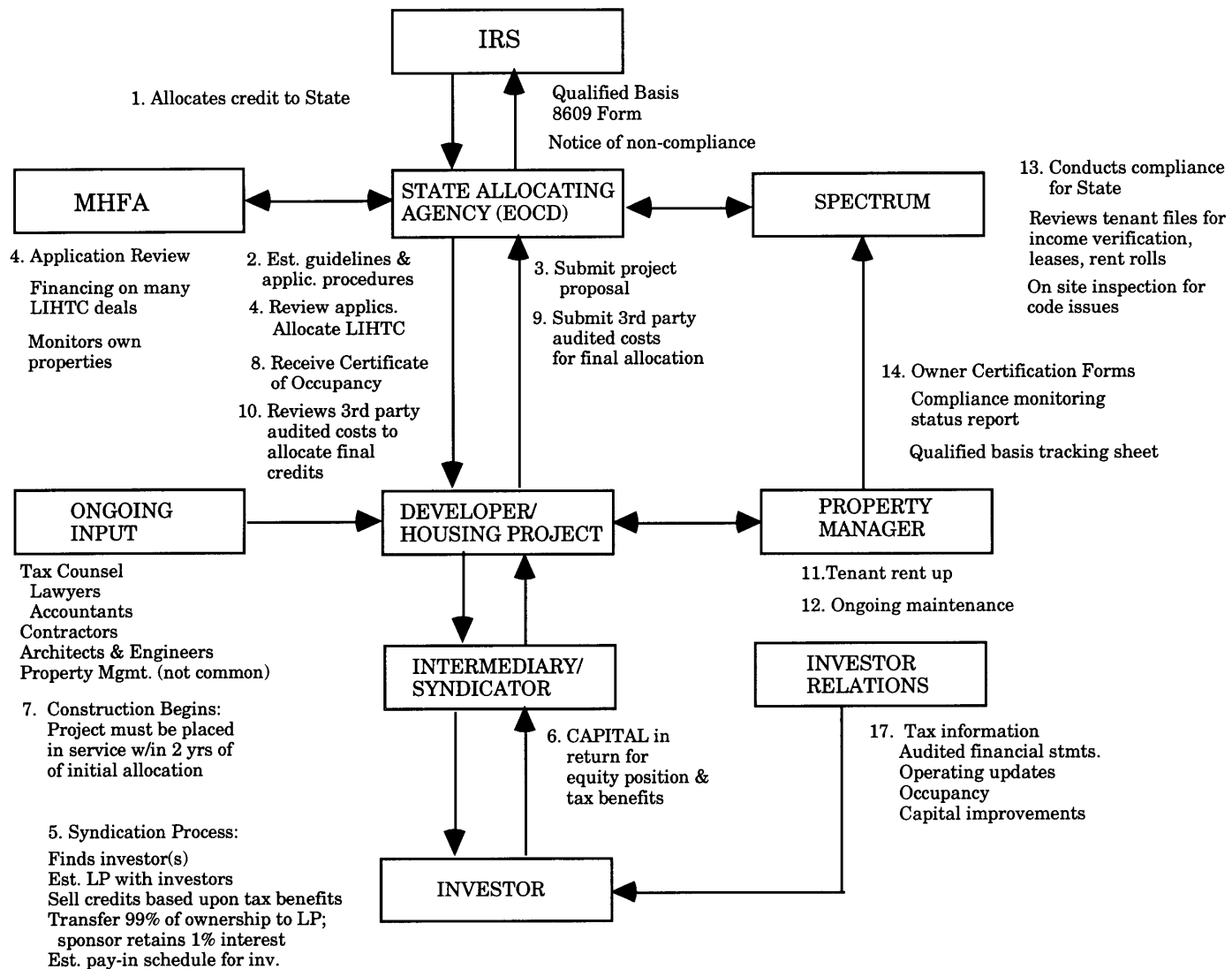
Chapter 5 provides two case studies of Massachusetts projects. Each one is developed by a Boston based non-profit developer, but is located in a different market type to compare how the mechanics play out at the project level. What also is clear from these two examples is the significant role the market plays on the project in terms of income mixing and finding tenants. Chapter 6 provides some analysis and conclusions about the industry.

METHODOLOGY

This project incorporated four methods of gathering information: 1) a literature review; 2) program descriptions and allocation plans for Massachusetts 3) interviews with LIHTC administrators and monitors, property managers, developers, syndicators and policy makers; and 4) two case studies of urban LIHTC projects in Massachusetts.

The literature review provided an understanding of the affordable housing situation in this country as well as the LIHTC program. In conjunction with this review, the program descriptions and allocation plan established a context in which to examine the current situation. Speaking with the participants involved with the LIHTC clarified some of the more complicated aspects of the program and also provided statistical and anecdotal data. Finally, the case studies acted as a means of drawing the information together and grounding the analysis of the program in a "real world" situation.

**FIGURE 1.1
LIHTC PARTICIPANTS IN MASSACHUSETTS**



CHAPTER TWO: HOUSING OVERVIEW

THE NATION

Before specifically discussing the LIHTC, it is important to have an understanding of the industry to which it has become so critical. While LIHTC is a tax program, its primary purpose is to provide rental housing for moderate and low income households. The need for such housing has always been a concern and is no less so today. Although the government promised to provide a "decent place to live", its method of doing so has changed through the years. Since this thesis concentrates primarily on Massachusetts, State trends will be discussed in detail with national trends serving as context.

The national LIHTC program is intended to serve those households earning 60% and less than the Standard Metropolitan Statistical Area (SMSA) gross median income. While there are difficulties in accomplishing this agenda due to the program guidelines, certainly there is a need for such housing on both a national and State level. Evidence illustrates that supply and demand are not in equilibrium.

A 1992 report stated that "...the number of [the nation's] poor renters increased sharply, resulting in a severe shortage of low income housing. Some five million households currently pay more than 50% of their income for housing, or live in structurally inadequate or overcrowded units."⁷ Furthermore, 8.1 million renter households have incomes at, or below, the poverty line. Only 30% of these eligible households receive some type of housing assistance.⁸

⁷*State of the Nation's Housing 1992*, p. 4.

⁸ *Ibid.*, p. 17.

National rental costs actually decreased in 1991, but "income erosion has caused actual rent burdens to rise. Rental costs as a percentage of renter income rose above 30% for the third time in 25 years."⁹ Taking this one step further, one could compare median rents with poverty level income. In 1989, poverty level for a family of four was \$9,400 per year, while median rents were \$4,200 per year (\$350 per month), or 45% of the gross income.¹⁰

The supply of affordable housing has moved inversely to the demand. While the first quarter of 1994 has shown an increase in overall multi-family housing starts, that trend could alleviate only mildly the demand for affordable housing. Since 1988, overall multi-family rental starts have declined. (See Figure 2.1) Moreover, the supply of subsidized and unsubsidized apartments also diminished. Between 1974 and 1990, an average of 700,000 units were removed from the existing housing stock of which approximately 19% of them were low income.¹¹

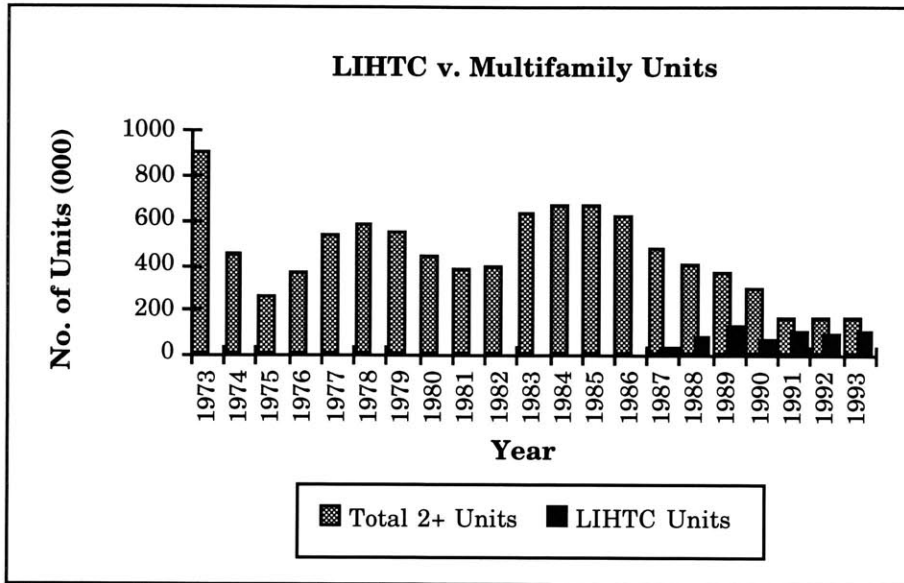
Statistics regarding rents and median income suggest a high demand for housing. One would assume the supply would follow. However, another method of observing demand is to examine vacancy rates. The building boom during the first half of the 1980's led to an overproduction of housing in general, and thus high vacancy rates. During the late 1980's and early 1990's, vacancy rates were over 7%. As a result, there was little incentive to build rental housing.

⁹Mitchell Pacelle, "Economy: Affordability of Home Buying is Rising, But Low Cost Rentals Wane," *Wall Street Journal*, (October 1, 1992), Section A, p. 2.

¹⁰*State of the Nation's Housing.*, p. 22.

¹¹*Ibid.*, p. 20.

Figure 2.1



Source: US Bureau of the Census, Construction Reports, Series C-20, Housing Starts, in Housing Market Statistics, Table 1, New Privately Owned Housing Unit Starts, May 1994 and November 1986. National Council of Finance Agencies

National low income housing starts slowed for other reasons. The federal government has relinquished its historic role as the primary provider of the nation's subsidized housing through the direct assistance method. Before 1959, public housing was the solution for those who could not afford market rate housing. During the 1950's, programs "tinkered with the credit mechanism" to produce low cost housing. Interest rates and down payments were lowered, payment terms lengthened and HUD produced many of the necessary affordable units. By the 1960's, other innovative programs to accommodate the supply side of the equation were set in place. Later, Section 8 certificates provided rental assistance on the demand side. These certificates filled the gap between fair market rents (FMR) and 30% of the tenant's income.

During the Reagan years, many observers and policy analysts thought the federal programs were costly and inefficient and that state and local assistance programs could more accurately tailor their programs to achieve specific results. The argument was that state and local governments were more attuned to their markets and housing needs. The "genius of the market" was to be the vehicle for solving the low income housing problem.

Between 1980 and 1990, the national General Housing Budget declined from \$32.2 billion (3.35% of the total budget) to \$7.9 billion (0.6% of the total budget) in real dollars. During that same period HUD assisted units decreased from 144,000 units to fewer than 22,000.¹² Section 8 as a means of production was eliminated under the Reagan Administration. A program that had once produced several hundred thousand units during the 1970's was reduced to a rental assistance program. Even so, new certificates are not being issued and the debate continues as to what will happen when the existing certificates expire.

During the 1980's state and local spending did increase significantly. However, "states have continued to devote a much smaller share of their own revenues to housing assistance than has the federal government."¹³ State and local programs accounted for only 18% of all governmental expenditures on housing and community development.

Massachusetts surfaced as one of the stronger states in terms of supplying affordable housing. On average it funnels \$40 per capita into housing and community development compared to the national average of \$2 per capita.

¹²Jonathon Klein and Lynn Wehrli, "The LIHTC: Federal Help for Low Income Housing," *Boston Bar Journal*, (July/August 1990), p. 22.

¹³Belsky, p. 5.

Subsidized housing in the State increased 22% during the 1980's. State programs such as State Housing Assistance for Rental Production (SHARP), Rental Development Action Loan (R-DAL) and Massachusetts Rental Voucher Program (MRVP -- formerly 707) ameliorated the reduction of federal assistance programs by providing gap financing and rental assistance. However, recently these programs have been eliminated or severely restricted, thereby aggravating the affordable housing situation in Massachusetts.

MASSACHUSETTS

The demand for low income units in Massachusetts did not subside as funding programs were cut. Currently, over 160,000 households pay more than 50% of their gross income towards rent and utilities. Approximately, 95% of those households are considered very low income, that is they earn less than 50% of the median. The majority of these households are large, with five or more people. Almost 20% live in overcrowded conditions.¹⁴

Clearly, both at a national level and in the State of Massachusetts, low income housing needs are a concern. There appear to be more poor people pursuing fewer lower priced units. Without incentives or assistance to build affordable housing, private developers will not do so since they cannot command the rents to support debt on low income projects. The LIHTC serves as an impetus for such projects.

¹⁴EOCD, *1994 Allocation Plan for the Low Income Housing Tax Credit*, Commonwealth of Massachusetts, (April 1994), p. 2.

CHAPTER THREE: LIHTC OVERVIEW

ORIGIN

Using the nation's tax system to stimulate the housing supply is not a new concept. Although the IRS has altered the provisions throughout the years, generally there have been tax benefits for the development of market rate and affordable housing.

The most substantial federal housing subsidy benefits upper and middle income property owners. By allowing mortgage interest and property tax deductions on federal tax returns, the government loses \$55.5 billion per year in revenue. An additional \$21.3 billion is lost due to capital gains benefits.¹⁵

Before 1986, developers of affordable and market rate rental housing reaped substantial benefits through 15-year depreciation schedules, passive loss and special capital gains provisions. In addition, low income housing benefited through the use of an accelerated 200% declining balance form of depreciation and the deduction of construction period interest and taxes.

The 1986 Tax Reform Act (TRA 86) dramatically changed this scenario by eliminating incentives that previously encouraged the development, acquisition and operation of real estate. The depreciable life for residential buildings was extended to 27.5 years, using a straight line versus accelerated method, passive losses were severely restricted, and special capital gains treatment was eliminated.¹⁶

¹⁵Cushing Dolbeare, *At a Snail's Pace, FY 1993*, p. 4.

¹⁶The August 1993 tax reform act reinstated special capital gains treatment.

While market rate rentals "went from a tax-favored status to among the least favorably treated investments,"¹⁷ low income housing tax treatment continued to enjoy preferential tax treatment with the implementation of the LIHTC. TRA 86 was a reactive step to market rate developers reaping benefits. Policy makers felt that there should be some "public good" if an investment incentive was to exist at all. For qualified investors, the credit provides a dollar-for-dollar reduction in the tax liability as well as passive loss privileges. A credit is preferential to a deduction in that it reduces the amount of tax owed rather than the amount of taxable income.

The continued use of the tax system as a means of producing low income housing complemented the federal government's policy of "getting out of the housing business." The LIHTC uses "public-private partnerships to solve problems at the community level,"¹⁸ thereby reducing the bureaucracy of federal direct assistance programs. Although the federal government is responsible for funding the program, it has transferred the responsibility for housing production to separate industries and professional groups.

*It takes only three federal bureaucrats in the Treasury Department and the IRS to administer the tax credit program. The federal government is thus spared large administrative costs, and tax credit projects are spared heavy handed regulation by HUD.*¹⁹

¹⁷Patrick Clancy, *Tax Incentives and Federal Housing Programs: Proposed Principles for the 1980's*, HP #11, MIT Housing Policy Project, MIT Center for Real Estate Development, (May 1988), p. 4.

¹⁸Laurie McGinley, "Economy: Tax Credit is Likely to Spur Mild Boom in Construction of Affordable Housing," *Wall Street Journal*, (September 29, 1993), p.2.

¹⁹Rochelle L. Stanfield, "Big Money in Low Rents," *National Journal*, (May 7, 1994), p. 1069.

The projects are subjected to the discipline and integrity of the financial marketplace, encouraging a more efficient process as well as quality product.

The very fact that accomplished developers come to the table supported by the confidence of the marketplace demonstrated through the availability of capital, provides assurance to governmental actors that is often critical to loosening what can otherwise become overly rigid and costly bureaucratic underwriting processes.²⁰

Another incentive behind the LIHTC is its budget mechanism. Since the LIHTC is "not reflected in governmental appropriations, but in reduced income tax collections, [it] has often historically resulted in less scrutiny and review of the expenditure..."²¹ In these days of public scrutiny of the federal budget, this aspect is essential in maintaining political support. While the overall cost of the program may not be as evident as the direct spending of previous methods, it is controlled by Congress since yearly allocations are limited to \$1.25 per capita, thereby restricting the total number of credits claimed by investors each year. Previous tax incentive programs had no application process. Developers and investors could claim credits as long as they complied with the basic requirements. Since there were no limits, it was difficult to control overall expense. In 1994, the total allotment of new credits was approximately \$3.3 billion.²² Compared to the \$76.8 billion subsidy for property owners, this program has a much smaller impact on the federal coffers.

Since 1987 the LIHTC is the most substantial means of encouraging the construction and rehabilitation of low income rental housing. To date it has

²⁰Clancy, p. 10.

²¹Clancy, p. 7.

²²Source: Joint Tax Committee, Washington, D.C.

been responsible for the construction and rehabilitation of over 600,000 low income units nationally or more than 90% of the affordable housing built in recent years.²³ In Massachusetts alone, almost 10,000 units were constructed as of 1993. (See Figure 3.1)

²³McGinley, p. 2.

**Figure 3.1
LIHTC Information**

Tax Credit Usage (000's for \$ amounts)

United States

	1987	1988	1989	1990	1991	1992	1993	Total
Total Authority Availbale	\$313,114	\$311,487	\$314,231	\$317,675	\$497,170	\$488,507	\$546,370	\$2,788,554
Total Allocated	\$62,886	\$209,780	\$307,183	\$213,146	\$400,421	\$337,032	\$424,702	\$1,955,150
Percent Allocated	20%	67%	98%	67%	81%	69%	78%	70%
Total Projects	1,369	3,060	3,647	N/A	N/A	N/A	N/A	
No. of LIHTC Units Built	34,491	81,408	126,200	74,029	111,970	91,300	103,756	623,154
Market Units	3,673	13,459	5,502	N/A	N/A	N/A	N/A	

Tax Credit Usage (000's for \$ amounts)

Massachusetts

	1987	1988	1989	1990	1991	1992	1993	Total
Total Authority Availbale	\$7,290	\$7,319	\$7,391	\$7,391	\$14,783	\$13,609	\$12,777	\$70,560
Total Allocated	\$4,292	\$7,319	\$7,391	\$7,016	\$14,783	\$9,028	\$9,364	\$59,193
Percent Allocated	59%	100%	100%	95%	100%	66%	73%	84%
Total Projects	18	35	21	27	27	29	22	179
No. of LIHTC Units Built	1,361	1,730	1,534	1,147	1,166	1,238	1,774	9,950
Market Units	111	316	330	170	159	21	207	1,314

Source: National Council of State Housing Agencies
Executive Office of Communities and Development, Boston, MA

CHAPTER FOUR: THE LIHTC AND ITS PARTICIPANTS

Chapter Three discusses the fundamental reasons for the federal government to foster an investment incentive program to create affordable housing. With this background one can examine the LIHTC process from its starting point with the IRS to its finish at the property management and project level.

While the LIHTC is a federal program, it contains elements of the 1980's decentralized housing policy by allowing the states full autonomy over what type of housing gets built in their jurisdiction as well as incorporating the "genius of the market". The IRS is responsible for setting the general guidelines while the state allocating agencies customize the program to meet their housing needs. These two agencies are responsible for establishing the overall policy framework in which the participants operate. (See Figure 1.1)

The participants have their own hierarchy in the LIHTC program and are responsible for making decisions which influence the subsequent step of the development process. These participants each have a restricted view of how their actions affect one another. Their contact with the program is limited to their expertise in the industry and they may not realize the inevitable ramifications down the line. The engineer of this process is the developer of the project. This entity must structure the deal and undertake issues of financing structure and investors.²⁴ The decisions made at this level in conjunction with the constraints of the overall LIHTC guidelines as well as the housing market, impact the property manager and the project itself. Management level

²⁴Some projects have a separate syndicator. For purposes of discussion, this paper will assume that the developer and syndicator are one in the same.

concerns tend to address rent and income level caps as they relate to qualified tenants. The other significant issue is the intense administrative requirements which detract their attention away from day-to-day management responsibilities.

The following chapter examines each step of the LIHTC process to establish the framework which impacts the property manager. IRS and State guidelines are outlined as a context for understanding the player's actions. Issues at the developer/syndicator level as well as the role of the investor are discussed. These relationships are important in understanding the impact on the manager.

IRS GUIDELINES

The LIHTC program is governed by the IRS, with its rules and regulations spelled out in Section 42 of the IRC. Section 42 establishes the general program guidelines for calculating the credit in terms of reserving a minimum number of low income units per project, defining eligible tenants, limiting rent and income, outlining financing sources that can be used in conjunction with the LIHTC and establishing guidelines for monitoring projects once they are complete. It also sets the limit for the tax benefit as well as the affordable life of the project. Investors can claim the credit for ten years, the project must remain affordable for a minimum of 15 years. This section explores the guidelines just mentioned as they relate to the impact on the players and the project. As a tax program, the LIHTC is full of highly rigid regulations to which the participants must adhere. An overview of these statutes is fundamental to understanding the process.

Calculating the Credit

The number of eligible credits a project can receive is calculated via a standard formula using a project's *eligible basis* (total acquisition cost - land - other non-depreciable expenses). If it is a rehabilitation project, then the total development cost (including developer's fee, but excluding acquisition cost and other non-depreciable expenses) is used. The eligible basis, whether development or rehab, is then multiplied by the lesser of 1) the percent of tax credit units or 2) the percent of total floor space of low income units in the project. The product is the *qualified basis*. The qualified basis is then multiplied by the *applicable percentage* determined by the Treasury -- 4% or 9%. The 4% and 9% vary slightly every year because the Treasury alters the applicable discount rate. The credits are also referred to as 30% and 70% because the applicable percentage over 10 years (the amount of time for which the credit is taken) is equal to the present value of either 30% or 70% of the qualified basis.

The 4% or 9% credit is determined by the type of project and/or other financing sources. Substantial rehabilitation (\$3,000/unit or 10% of the project's adjusted rehabilitation eligible basis) and new construction qualify for the 9% credit. The 4% credit is applied towards acquisition and moderate rehab projects. Most projects with government subsidies such as below market rate loans and non-taxable bond financing will also only receive the 4% credit. The 9% credit can be used with market rate loans, Community Development Block Grant (CDBG) money, taxable bond financing and, in limited cases, HOME funds. Rental assistance subsidies such as Section 8 and MRVP can also be used with the 9% credit.

Projects which receive at least 50% or more of their financing from tax exempt bonds automatically receive the 4% credit without deducting any credits from the total state allotment. (However, there is a limit on the amount of tax-exempt bonds a state can issue.) This type of credit is often referred to as the non-competitive credit. Theoretically, a state could distribute all its “competitive” tax credits and there still could be additional projects financed by the LIHTC due to this provision.

Minimum Set Asides

The credit can only be applied to those units which are designated as low income units. Section 42 of the IRC stipulates that each LIHTC building must have a minimum of either 20% of the units set aside for those with gross incomes of 50% or less than the median income, (the "20/50" set up) or 40% of the units for tenants earning 60% or less than the median income (the "40/60" set up). Though a developer can certainly set aside more than 20% or 40% of the units for tax credit purposes, the arrangement selected for a building in the first year, is set for the life of the project. If the number of LIHTC units dips below what was initially stipulated, then there could be a recapture of credits.

Income Limit

Tax credit units are meant to serve households earning either under 50% or 60% of the median income of the Standard Metropolitan Statistical Area (SMSA) . The benchmark is determined at the beginning of the project and must be complied with throughout the affordable life of the project²⁵. All limits are based upon gross income. Thus, taxes, social security, disability, and child

²⁵Investors receive credits for 10 years although the affordable life of the project is 15. However, some states, such as Massachusetts, have a 30 year requirement.

support are included in one's total income. Households receiving rental assistance vouchers are not required to include the subsidy as part of their income.

Rent

All LIHTC rent caps are based on gross rents which includes utilities. Gross rent on tax credit units cannot exceed 30% of the relevant imputed gross income. That is, if a project has been structured so that at least 40% of the units are set aside for those who make 60% or less than the SMSA gross median income, then the rent cap is 30% of the 60% figure. Since 1990, apartment size, rather than family size, has been used for the gross rent limitation on an apartment of one or more bedrooms. The rent schedule is established using 1.5 persons per bedroom unless the unit is an SRO or studio. Before 1990, apartment rents were based upon the number of people in a unit rather than the unit size. Thus a four person household in a two bedroom unit would pay more than a 3-person household in the same size unit.

Compliance Monitoring

Every project must be in compliance with the federal regulations or the IRS can recapture the credits. A credit recapture can take place on a per unit or project-wide basis, depending upon the infraction. Investors lose their tax benefit and are also subject to a penalty.

While the IRS has always been concerned with a project maintaining compliance, it was not until 1992 that it became mandatory for every state to monitor projects. At that time the "20/20 rule" was established, requiring that 20% of the LIHTC projects within each state be reviewed annually. Within

each project, 20% of the units also must be investigated. Review constitutes a physical inspection of the property to assure that there are no code violations as well as examination of tenant files. As with other rules, each state can alter the number of units examined as long as it meets the minimum 20%. Massachusetts, for example, has adopted a 33/20 method, whereby 33% of the projects in the State are examined each year. They still follow the IRS guideline of reviewing 20% of the units. Rather than have the allocating agency perform compliance monitoring, Massachusetts has hired an external monitor, Spectrum Associates, an agency which performs the service in other states.

Credit Recapture

The threat of recapture is omnipresent throughout the LIHTC discussion. While the ramifications could be tremendous, at this point, the "bark is worse than the bite". One would expect that, given all the compliance requirements, there would be a great number of recaptured credits. It has taken the participants a while to understand and be able to work with the program. After seven years into the LIHTC program, developers, syndicators, managers and investors are still attempting to grasp a full working knowledge of the LIHTC. Credit recapture warrants a brief discussion since it is an integral part of the property manager's compliance maintenance.

Recapture can occur on a unit or project wide basis depending upon the infraction. The development must always maintain the minimum 20% or 40% unit set aside to avoid a project wide recapture. A reduction in the qualified basis (i.e. the number of qualified low income units originally claimed), but maintenance of the minimum eligibility requirements, will result in a unit

recapture. Recapture can occur any time during the first 15 years of the project's life, even though the credit is only claimed for the first 10 years.

The further into the project a recapture takes place, the worse the penalty. "Non-compliance during the first eleven years of the project's compliance period requires taxpayers to pay back one-third of all those credits taken in previous years that are related to the extent of non-compliance, plus interest."²⁶ An additional penalty fine can also be inflicted.

However, even if non-compliance is reported to the IRS, as it must be at year's end, the owner has a grace period of 90 days in which to correct the problem. This time frame can be extended if just cause is shown. Some problems are not easily rectified. If an unqualified tenant was knowingly rented a LIHTC apartment by an owner or manager, the tenant cannot be evicted. Since LIHTC leases must be a yearlong, the owner could not easily correct the situation.

Thus far, there has been no tally on the number of recaptured units. The IRS has not been stringent in monitoring the program since it was only recently made permanent. There are no guidelines to audit Section 42 projects, rather it is up to the discretion of IRS district directors. One official said, "Now that the credit is permanent, there will be more of a bite in the next 18 - 24 months. Enforcement will probably increase." Anecdotal evidence suggests that, for the most part, it is not a matter of the IRS recapturing credits, but of

²⁶Joseph Guggenheim, *Tax Credits for Low Income Housing*, (Maryland: Simon Publications, 1992), p. 69.

investors not claiming the full amount. Thus far, the primary reason for recapture is fraud, though only one case has been widely publicized.

These mechanics establish the framework in which the participants must operate. They are necessary to understand in discussing the issues which arise in structuring the deal as well as the management of the property. These stringent regulations set the boundaries in which the players can structure a deal.

STATE PROCESS

The program guidelines outlined by the IRS are passed on to each state agency responsible for tax credit allocation. Typically, it is the state housing finance agency (HFA) which is in charge of this process; however, in Massachusetts, it is the Executive Office of Communities and Development (EOCD). In either case, the agency is obligated to establish an allocation plan and program guidelines based upon the minimum IRC requirements and the state's housing needs. What the IRS lacks in housing knowledge, the allocating agency is presumed to make up for. In addition to governing the LIHTC program, HFAs, and EOCD in Massachusetts, have experience funding other affordable housing endeavors.

The allocation plan typically outlines the goals each state is attempting to meet. A certain percentage of the total allotted credits are set aside for particular project types -- such as multi-family, elderly or special needs and new construction or rehabilitation. In addition to meeting minimum requirements, such as number of units, creditworthiness, site control and financial feasibility, a project is then graded in a variety of categories using a

point system. Each category has a different point total, indicating its relative overall importance. For instance, the Massachusetts guidelines designate design and readiness to proceed worth 35 points each, whereas local support is only worth 10 points. A project must receive a minimum percentage of points in each category in order to receive credits.

State agencies evaluate proposals submitted by development teams as to whether or not they should receive tax credits. Unlike previous tax based investment incentive programs, where credits were not allocated, but just claimed, the LIHTC does not have unlimited use. If a project meets the criteria outlined in the State plan, then the agency allocates the least number of credits to make the project feasible. Due to this provision, most project sponsors or developers have some financing sources in line before applying for credits. If the project does not appear financially possible, then it is difficult to obtain tax credits.

States are not required to allocate the full amount of credits they receive each year. Should the full amount not be allotted, then the remaining credits can be carried over to the following year. Credits not allocated in the subsequent year are turned over to the national pool to be allocated to other states. Throughout the history of the tax credit, almost 60% of the states have issued less than half their available credits.²⁷

State guidelines further shape the way in which the participants' role plays out in the LIHTC process. It administers and customizes the LIHTC program to meet its housing needs. It is up to the developer, syndicator and manager to

²⁷Source: National Council of State Housing Agencies

structure and execute projects that fit within these confines. What becomes clear, however, is that many issues arise in their attempts to achieve their goals.

DEVELOPER AND SYNDICATOR ISSUES

Developers obtain credits from the state through an application process. After an evaluation of a project proposal, the state will issue credits based upon the least amount necessary to make the project financially feasible. Developers can then raise capital to produce low income housing by selling the credits to investors. Both steps of this process pose challenges for the developer and syndicator. These players must overcome several hurdles -- the "new paradigm" method of financing, unit mix and finding investors -- which affect their roles in the LIHTC process.

The New Paradigm

Under the Omnibus Reconciliation Act of 1989, each state is required to have an allocation plan and ensure that it allocates the *least* number of credits necessary to make the project financially feasible. No project can be financed 100% by the LIHTC and thus other financing sources must be obtained. The credit can provide up to 50% of the equity needed to finance a project, depending upon location. In areas with high construction costs, such as Massachusetts, the contribution may be less. Nationwide, the average tax credit issued on a per unit basis is \$3,500.²⁸

Due to the constraints imposed by the IRC, most affordable housing financed today has numerous funding sources -- a combination of debt, equity (tax

²⁸David D'Allesandris, "Multi-Family Housing Activity," *Housing Economics*, Volume XXXXII, Number 5, (May 1994), p. 17.

credits) and grants or "soft" loans. Many of the secondary financing sources depend upon a strong economic forecast for the market in which the housing is located so that operating income increases to cover rising expenses. This method of layering financing combined with the tenuous nature of finding additional sources has been dubbed the "new paradigm" by many observers. It contrasts the subsidized development world of the Section 8 program and its predecessors where "one stop shopping" was possible at HUD.

Financing becomes multi-layered for other reasons as well. Construction costs, investor pay-in schedules and rents all influence the additional amount of financing required to make a project feasible. Such financing is difficult to acquire because the LIHTC program limits the type of funds that can be used in conjunction with the 9% credit. With diminishing state funds available, financing LIHTC projects becomes a challenge. There have been instances when a developer or sponsor can obtain credits, but not enough additional financing to make the project work. Credits are then returned to the state pool if the project is not placed in service within 24 months of receipt.²⁹

Areas with high construction costs tend to require more financing sources thereby contributing to the complexity of the deal. States receive no special dispensation for high construction costs. Since the state is limited in the total number of credits available and in light of its need to create as much housing as possible, it cannot significantly increase the number of credits allotted to a developer in order to make the project possible. In order to accommodate the higher cost of building, developers must seek other sources of financing. In

²⁹Placed in service for tax credit purposes requires a certificate of occupancy.

areas with high construction costs, up to 10 lenders have been necessary to make a project work financially.

Bridge loans usually account for one of the layers of financing. Investors do not contribute the full amount of equity up front. Pay-in schedules can vary from 2 - 6 years, depending upon the structure of the deal (they can even go longer than 6 years). Thus, there are usually insufficient proceeds prior to the construction loan closing. As a result, a bridge loan is necessary, adding to the total cost of the project. Bridge loan interest should be minimized in order to increase the yield to the project.

Due to the way rents are established, only those earning incomes at the upper end of the 50% or 60% income limit, depending on which "set up" was designated, can comfortably afford the rents. This situation greatly impacts the financing.

To make apartments affordable to poorer people -- 30% or 40% of median income, rather than 60% -- requires more subsidies and a still more complex deal. Groups that really want to serve the homeless and the poorest end up with the highest transaction costs and the most complicated projects.³⁰

Of course the amount of debt the project can carry is limited. Rents are capped as required by Section 42 and there is a limit to the percent increase per year. The lower the rents, the lower the net operating income (NOI), the smaller the loan amount. In addition to the \$275 per unit per year operating reserve required by the IRS, lenders will also insist on a generous reserve to

³⁰Michael Stegman, Assistant Secretary for Policy Development at HUD, as stated in Stanfield, p. 1070.

protect cash flow for debt service. To complicate matters further, the IRS income constraints do not necessarily coincide with interest rate fluctuations. Interest rates are market driven and thus can vary. In periods of high or increasing interest rates, debt service becomes more expensive. The developer has to be concerned with covering debt service and that the amount of debt does not exceed the value of the property at the end of the "affordable life" of the project (15 years typically, 30 years in Massachusetts). With restricted income, it is difficult to rely on debt as the only other source of financing on LIHTC projects.

The "new paradigm" method of financing not only complicates the feasibility of the project, but also impacts the tenant and the manager. Some financing sources are sufficient to lower rents below the caps set by the IRC guidelines. In markets with high rent caps, such financing is almost a necessity in order for the project to work. Many of the lower income tenants could not afford the rents without either rental assistance or another means of reduced rent. The manager is left having to guard closely guard tenant rents for compliance with the program.

Unit Mix

As discussed, every LIHTC project must have a minimum "20/50" set up or "40/60" set up. The difficulty here is determining the right mix. From a financial point of view, the greater the number of tax credit units, the more capital available. However, it is crucial to determine the demand for these units, since there are stringent tenant eligibility requirements which will be discussed further. If the market cannot support the proposed LIHTC units, then the property faces either lost operating income or a credit recapture if the

units are filled with ineligible tenants. In this situation it would not be worth exceeding the minimum number of required units. The opposite scenario could occur in a weaker market. That is, if the median income were low and the majority of the potential applicants were low income, then it would not be worth structuring a deal with a majority of market rate units because it could be difficult to fill them without rental assistance. If a significant portion of the tenants are going to be low income, then the amount of equity into the deal might as well be maximized by designating all the units LIHTC. What becomes clear is that the micro economy plays an integral role not only in originally structuring a LIHTC deal, but also in its ultimate success.

The Investor

Investors benefit from the credit because they are able to reduce the amount of tax they owe (versus a deduction which is a reduction of taxable income). Corporations have unlimited use of the credit, though it cannot be applied to reduce the alternative minimum tax. Individuals, also subject to the alternative minimum tax, can apply the credit against a maximum amount of \$25,000. For those in the 39.6% tax bracket (the highest), this translates to \$9,900 per year of credit.

Depending upon the type of investor, paper losses can be another benefit. Corporate investors have unlimited use of passive losses whereas individuals may offset up to \$25,000 of non-passive income by using losses and credits from rental real estate activities in which they actively participate. They also must have at least 10% interest in the property and they may use these losses only if they do not have enough passive income on which to apply the credit or losses. With such restrictions, few individuals are eligible to invest in LIHTC

projects. Most investors are corporations which not only benefit monetarily, but also socially since their image is enhanced by their community participation.

Since individual investors are limited and corporate investors provide their own investment constraints, in order to maximize the amount of equity available to the project, typically a pool of investors is formed. Developers either seek out investors themselves or use a syndicator who specializes in structuring pools for LIHTC deals. The amount of capital raised varies with the method of locating and pooling investors. Typically, there are higher transactions costs with deals formed by syndicators than those with private placements. However, each method has its own benefits as well as challenges.

A specially formed limited partnership, similar to traditionally syndicated real estate deals, ends up owning the building(s). The limited partnership is an entity in which tax benefits and liabilities are passed through to the partners. Tax credit investors become the limited partners with 99% ownership and limited liability. The developer, or sponsor, acts as the general partner, with all management rights, owning the other 1%. The general partner also carries most of the partnership liability. Once this ownership arrangement is established, the tax credit project cannot be severed from it. That is, investors cannot sell their partnership interest. To do so would subject the project to a recapture of credits. In which case, the investors not only lose their investment, but also are liable for penalty fines and interest payments. The older the project, the more severe the ramifications.

In the early days of the LIHTC, investors were difficult to come by due to the tenuous existence of the program. It was risky to invest in a project that had a three-year life and then year-to-year extensions. Furthermore, due to the recession, many corporations were not as concerned with their "tax appetite" as they were with their day-to-day existence. Planning for future tax liabilities was not a primary concern. There were more deals than there were interested investors.

Since the tax credit was made permanent in August of 1993, and as the economy strengthens, the tables are beginning to turn. A greater number of investors are interested in deals. Tax credit deals fall into several categories which vary due to the socio-economic structure of each state. The ability to obtain investors weighs heavily on the type of project. In all cases, sponsors of LIHTC transactions can be either for-profit or non-profit. In fact, per Section 42, each state is required to set aside 10% of its allotted credits for non-profit developers.

Suburban and Urban Projects

Typically, most for-profit sponsors have projects in suburban³¹ communities with a strong marketplace. Construction costs can be lower than inner city projects. Median incomes are higher and thus, so are rents, indicating a healthier cash flow for the project. These characteristics lead to deals where the tax credit contributes a significant amount of the necessary equity and less additional financing is required. The deals are straightforward and overall less

³¹Suburban community is used for purposes of discussion. The terminology refers to all non-urban inner city deals.

risky, making them more attractive to corporate investors who have limited experience in low income housing investments.

The other end of the spectrum is the inner city or urban project characteristic of most deals sponsored by non-profit organizations. These projects tend to be located in areas with higher construction costs and low median incomes. Financing becomes multi-layered to accommodate high costs as well as to reduce rents to attract the lower income tenants. While tenants may be income eligible for the unit, they may not be able to afford the rent without another form of assistance, which, these days, is difficult to obtain.

Anecdotal evidence suggests that thus far, investors have been more interested in the for-profit suburban type of deal because it is less risky. Low income housing as an investment is new to most corporations and thus, they are uneasy about putting money into complicated urban deals. There are no provisions in the tax code against "redlining". That is, when developers approach syndicators about a project, an investor has the right to indicate what type of project s/he wants a stake in. The investor can avoid projects in inner cities for whatever reason. This situation makes obtaining investors for inner city deals more difficult since they appear more risky. Although the discount rate would be increased to accommodate for the risk, many investors, having limited experience with affordable housing, are hesitant to take on the additional risk.

Developers of inner city, urban projects, are often left to find either their own investors or to adjust their projects to fit the investor's requirements. In Massachusetts, the majority of the projects are urban. Construction costs are

high across the State, making multi-layered financing commonplace. While some markets are stronger than others, as will be discussed in the case studies in Chapter 5, each brings about its own problems.

Massachusetts, with the majority of its LIHTC projects located in the inner city and sponsored by non-profit developers, has been able to overcome these difficulties for several reasons. There is a sophisticated and experienced non-profit sector in the State. Furthermore, there is support from local banks. The Massachusetts Housing Investment Corporation (MHIC) is a consortium of private banks which invest in LIHTC projects. Formed in 1990, MHIC agreed to receive a lower return on investment in exchange for Community Reinvestment Act (CRA) credit. Since MHIC can only obtain CRA credit on urban deals, for the most part, the relationship between them and the non-profit developers is mutually beneficial. As most of the deals in Massachusetts are urban, non-profit sponsored, the majority of deals do go to MHIC.

Another hurdle for non-profit developers is the accounting methods allowed under Section 42. Depending upon the type of investment, either the cost or equity method of accounting can be employed. The more desirable cost method of accounting allows the investor to "write down" the full investment in the first year. However, as it now stands, this method can be used only if there is a profit at the end of the 15 year lock-in period. Projects sponsored by for-profit developers usually have a residual value since they are profit driven. Without that motive, non-profit developers siphon additional cash flow back into the property, meaning that the equity method of accounting must be used. In this case, the investment is "written down" each year which is not as beneficial to

the investor. The accounting method thus makes the for-profit deals more desirable.

The issue is that in some areas it may be difficult to build urban projects without amendments to Section 42 limiting the attractiveness of for-profit suburban deals over non-profit inner city projects.

MANAGEMENT LEVEL ISSUES

While it is the owner's responsibility to maintain compliance, the owner is not always the one responsible for running the project on a day-to-day basis. Most multi-family residences, whether affordable or market rate housing, retain a property management company or a firm with a property management division. It is responsible not only for marketing and renting the units, but also assuring that the physical plant is in order mechanically, electrically and aesthetically. Essentially, a property manager is the owner's representative. In either case, whether the owner or a property manager attend the property, project compliance with LIHTC regulations is a critical issue.

For LIHTC projects, the property manager's role is complicated further by the fact that s/he must guarantee that every tax credit unit maintains compliance with the program. Affordable housing developments often require more intense management due to the socio-economic challenges of the areas in which they are located. In addition to these responsibilities, the manager also must deal with the demanding administrative duties of the LIHTC. While some regulations may make fiscal sense, they do not necessarily work with the day-to-day realities of housing issues. Some of the Section 42 mandates regarding original qualification, income and rent levels, continued occupancy and

recertification as well as building definition, warrant discussion in light of their impact on the manager as well as on the project. These factors have a significant influence on the housing policy issue of unit mix which will be discussed at the end of the section.

Original Qualification

Per Section 42 of the IRC, every tenant occupying a tax credit unit must be certified for income eligibility either below 50% or 60% of the SMSA gross median income. The certification should be third party, preferably by the Housing Authority or a HUD 50058 form. Even if a potential tenant participates in another subsidy program (e.g. Section 8), income certification for other programs are not sufficient for the LIHTC qualifications. Such certification can be used as a starting point, but the manager still has to verify whether the tenant's income is tax credit eligible. One can qualify for Section 8 or a similar program and not necessarily for the LIHTC. Tax returns can be used in cases where an individual is self-employed, but are not sufficient in most other cases. The program requires *current* and potential income while a tax return only supplies previous information. Furthermore, some money received may not be taxable and there will not show up on the tax return. However, for LIHTC purposes it should be counted.

Originally qualifying for an LIHTC unit can be difficult. In order to meet the income cap, some prospective tenants may be forced to hide income sources. Managers who must investigate tenant income are also caught in a difficult position. They must rely on tenant information to perform the investigation, yet it may not be sufficient to paint the whole picture. One property manager stated,

The major problem with the tax credit program is that the window of people who qualify is very narrow. You cannot have two people working. You can have one person working at an okay level job and another at best part-time. You end up having to turn down a working family and accept people who pay an enormous percent of their income towards rent. There is a huge gap between the working family and the family on public assistance.³²

Should the manager not be able to obtain any of the forms just mentioned then s/he will have to conduct his/her own investigation. The search must include contacting the present employer to verify the tenant's current salary and whether or not the individual is subject to a raise in the near future. Such an increase, even if only for cost of living, could jeopardize the tenant's eligibility.

The potential tenant also must be interviewed regarding other employment and sources of income. The property manager must rely on the individual's word and typically requires the tenant to sign something verifying his/her status. Technically, the owner is still held responsible and the unit subject to credit recapture should it be determined, at a later date, that the tenant was lying. Moreover, depending upon the lease agreement, the tenant could be evicted.

Income

As discussed, a household can earn up to 60% of the SMSA median income in order to qualify for a tax credit unit. This calculation becomes a significant component in determining eligibility for a LIHTC unit. Household income, in addition to being low enough to qualify for one of these units, must also be high

³²Myra B. Carlow, The Community Builders, Boston, MA.

enough to afford the rent. Most property managers, whether renting to a market rate or affordable household, will limit the percentage of income a household can pay towards rent. If a household has a rental assistance voucher or certificate then chances are that they are paying only 30% of their income towards rent. In some cases, they could be paying more. In instances where a household does not have rental assistance, then some managers will not allow a tenant to pay more than 40% of their income towards rent. With such limitations, there can often be a narrow window of eligible tenants. Before embarking on a full discussion of tenant income, it is helpful to understand the rent caps stipulated by the LIHTC program.

Rent

Rents on LIHTC apartments are capped at 30% of the relevant imputed gross income. Thus, if a project is a "40/60" set up, then the rent cap is 30% of the 60% figure. All rents (and income) are adjusted for family size.

The majority of tax credit projects are arranged in the 40/60 set up. In Massachusetts, over 90% of the projects are 100% low income.³³ Thus, rents are always based upon the 60% gross median income figure. Anyone making less than 50% (for the 20/50 deals) or 60% of the median income, and who has no form of rental assistance, will have to pay a greater portion of his/her gross income for rent. An eligible household cannot be refused from an LIHTC unit for having rental assistance vouchers without breaking the law. Since rental assistance vouchers, such as Section 8 and MRVP in Massachusetts, are more difficult to acquire, many people are paying a greater portion of their

³³Source: Executive Office of Communities and Development

income towards rent. A 1992 housing study estimated that at the national level, 30% of eligible households receive no assistance.³⁴

For example, a four person family in the Boston metropolitan area can earn a gross income of \$30,780, or an hourly wage of \$14.80 and still be eligible to live in a LIHTC apartment. The rent on a 2-bedroom apartment for this family is \$693 or 27% of their gross income.

At the other end of the spectrum is the family of four with two people working at the minimum wage of \$4.25/hour. The combined gross income in this scenario is \$17,680. That salary could support a rent of \$442/month using the 30% of gross income rule. However, rent for a two bedroom apartment in Boston in a 40/60 project is \$693/month or 47% of their gross income.

Some evidence suggests that 75-80% of tax credit units in Massachusetts are occupied by tenants with rental assistance or some other subsidy lowering the rents. The other 20 - 25% of the units are occupied by families who are at the upper limit of the 60% of median income and pay rent without subsidy. The incomes for the subsidy holders range between \$6,000 and \$14,000 for a two-person household.³⁵

While it is almost imperative for a family in Massachusetts to have rental assistance to afford a LIHTC unit, it could fall into the category of qualifying for Section 8, or an equivalent program, but not for tax credit unit. To originally qualify for Section 8, a household must be at, or under, 50% of the

³⁴J*State of the Nation's Housing, 1992*, p. 2

³⁵Data supplied by The Community Builders, Boston, MA

SMSA median income. However, the household can continue to receive this assistance even if it surpasses this threshold. Thus, a family earning slightly over 60% of the SMSA median income could have Section 8 certificates, but not qualify for the LIHTC unit. The requirements for both programs are not necessarily coordinated.

A tenant can use Section 8 certificates or comparable federal, state or local rental assistance with the LIHTC. The Massachusetts rental assistance program is MRVP. Under the Section 8 program a tenant pays no more than 30% of his/her own income (v. 30% of the SMSA median income). MRVP regulations differ. Tenant based MRVP is a voucher which is equal to a fixed amount, rather than a gap filler. Thus, a tenant could pay more than 30% of his/her income depending upon the rent. Project based MRVP operates in the same manner as Section 8 where the tenant only pays 30% of his/her income.

Rents for Section 8 and MRVP certificate holders are calculated differently than for LIHTC. Section 8 rents are based on fair market rents (FMRs) and MRVP rents are based on market adjusted rents (MARs) or a previously stipulated contract rent. FMRs, determined by HUD, tend to be higher than LIHTC rents and according to the IRC, an owner can collect the FMR from a certificate holder in a tax credit unit without violating Section 42. (See Figure 4.1) With Section 8 certificates, FMR is always collected no matter what 30% of the household income is. (See Figure 4.2) MRVP works slightly differently with LIHTC regulations. In this case, if 30% of the household income is higher than the LIHTC rent cap, then the additional income cannot be accepted in order to maintain compliance. (See Figure 4.3)

Figure 4.1

Section 8 Family in Boston Under Eligible Income	
<i>Family Size:</i>	4
<i>Apartment Size:</i>	2
<i>Median Income:</i>	\$51,300
<i>Eligible Income @ 60%:</i>	\$30,780
<i>Actual Income:</i>	\$17,680
<i>LIHTC Rent @ 30%:</i>	\$ 693
<i>Income Supported Rent:</i>	\$ 442
<i>Fair Market Rent:</i>	\$ 796
<i>Overage paid by Sec. 8:</i>	\$ 354

Figure 4.2

Section 8 Family in Boston at Eligible Income	
<i>Family Size:</i>	4
<i>Apartment Size:</i>	2
<i>Median Income:</i>	\$51,300
<i>Eligible Income @ 60%:</i>	\$30,780
<i>Actual Income:</i>	\$30,780
<i>LIHTC Rent @ 30%:</i>	\$ 693
<i>Fair Market Rent:</i>	\$ 796
<i>Overage paid by Sec. 8:</i>	\$ 103

Figure 4.3

MRVP Family in Boston at Eligible Income	
<i>Family Size:</i>	4
<i>Apartment Size:</i>	2
<i>Median Income:</i>	\$51,300
<i>Eligible Income @ 60%:</i>	\$30,780
<i>Actual Income:</i>	\$30,780
<i>LIHTC Rent @ 30%:</i>	\$ 693
<i>Contract or MAR rent:</i>	\$ 721
<i>Overage paid by MRVP:</i>	\$0

Rent caps are based upon 1.5 persons per bedroom. For example, a two bedroom apartment in Boston, regardless of income or family size, is set at \$693. Thus, as is evident in Figure 4.4, a family of three and a family of four can be paying the same rent for the same size apartment, even though a family of four is allowed to earn more income.

Figure 4.4

Family in Boston LIHTC Rent		
<u>Parameters:</u>	<u>Family of 4</u>	<u>Family of 3</u>
<i>Median Income:</i>	\$51,300	\$51,300
<i>Eligible Income at 60%</i>	\$30,780	\$27,720
<i>Apartment Size (# of bedrooms)</i>	2	2
<i>Monthly Income:</i>	\$ 2,565	\$ 2,310
<i>Amt. available for rent @ 30%:</i>	\$ 769	\$ 693
 <u>Rent Calculation:</u>		
<i>1.5 persons x 2 bedrooms:</i>	3	3
<i>3 person income:</i>	\$27,720	\$27,720
<i>Monthly Income:</i>	\$ 2,310	\$ 2,310
<i>Rent @ 30%:</i>	\$ 693	\$ 693

It should be noted that the maximum gross rent includes all utilities. If a tenant is responsible for paying his/her own utility bill, then rent has to be adjusted accordingly to include the projected utility amount. The state allocating agency usually publishes utility allowances based upon apartment size. Should a special telephone or television be required of all tenants for security purposes, then that fee would have to be included in the gross rent as would any other tenant requirements. Should these required provisions equal a sum greater than the rent cap, then the owner would be in non-compliance and again subject to recapture.

Continued Occupancy and Recertification

Once a tenant qualifies for a unit, s/he may remain in that unit indefinitely. A tenant cannot be evicted from a tax credit unit if s/he originally qualified. However, there are some issues with which the property manager must be concerned. If all the units in a project are designated as tax credit units and a tenant's income increases above the acceptable limit (140% of the LIHTC income cap), the tenant may remain and the limited partnership still may take the credit for tax purposes. Once the tenant moves out, the unit must be filled

with a tax-credit-eligible household. Theoretically, a household which originally qualified for the unit could undergo a significant lifestyle change, earning well above the median income and remain in the unit indefinitely.

The complications for the manager lie in the case where there is a mix of tax credit and market rate, or non LIHTC, units in a project. As in the 100% tax credit project, if a household originally qualifies, it may remain indefinitely and investors still receive the credit. However, once the household income rises above 140% of the eligible limit, the next available unit, no matter what the size or previous status (i.e. market rate or tax credit), must be rented to a tax credit eligible individual or family. Should the unit be rented at market rates, it could be subject to a credit recapture. Meanwhile, the household which experienced the over 140% income increase is subject to pay market rents.

The manager must constantly keep track of tenant incomes in order to maintain the equilibrium between market rate and LIHTC units. Typically, tenants are interviewed -- on the yearly anniversary of their move-in date -- regarding income and any changes in household size. Should they occur, they are required to report any significant lifestyle changes (family size, income) during the year. Tenant files are updated on a monthly basis, reflecting any tenure or reported lifestyle changes.

The irony is that, theoretically, a household is better off in a project where 100% of the units are designated as tax credit than in a mixed income project. In the case of the former, after originally qualifying, the household can remain indefinitely and not have to worry about a market rate rent increase because the project must remain 100% LIHTC throughout its affordable life. The

tenant in the mixed income project may always remain in the unit, but, depending on the lease agreement, can be subject to a rent increase should the household income increase past the 140% level. From the owner's point of view, there is no reason to maintain the lower tax credit rent for the tenant. The development does not gain any additional benefits by increasing the number of tax credit units at any given time. Whatever number of units are claimed in the first year are set for the affordable life of the project. The property could be losing income because the household is paying below market rate rent.

Should two apartments be available with one of them stipulated as a "next available unit" while the other is market rate, the LIHTC unit must be rented first or a recapture could occur. What is ironic is that the unit could remain vacant for years and still a credit can be taken as long as some marketing effort is shown. An owner must therefore choose between lost revenue or lost credit. Should the credit be lost there are investors to which one must answer. The project as a whole suffers with lost income.

Eligibility for an apartment is a unit issue, not a project or building issue. That is, even if a tenant originally qualifies for a unit and then wants to move within the same building or project, s/he still would have to pass the original income test. An increase or decrease in family size is no exception.

Multi-Building Issue

This issue becomes more complicated when there are several buildings in a project. The definition of building, as defined by Section 42, is a critical issue as it may not refer to simply the construct itself. A project with one physical

building poses no definition problem. It is when there are two or more buildings in a project that definitions play an important role. If two buildings are next to each other, across the street or alley, they may be considered one building. Otherwise, they are considered separate buildings. This definition of building can be detrimental or beneficial depending upon the situation.

In terms of LIHTC unit counts, it could be beneficial on a multi building project to consider the project as a whole rather than individual pieces. Each building originally can have a different mix of LIHTC and market rate units, but whatever is claimed in the first year is cast in stone as the minimum number for that building. Even though the project as a whole carries the correct percentage of units, each building must comply as well. The aggregate count is not relevant in this instance. (See Figure 4.5)

Figure 4.5

Sample Project with Multiple Buildings				
Project: 4 buildings; 48 units; 30 LIHTC units; 18 market rate units				
	Building 1	Building 2	Building 3	Building 4
<u>Year 1:</u>				
<i>No. LIHTC Units:</i>	8	7	8	7
<i>No. Mkt. Units:</i>	4	5	4	5
<u>Year 2:</u>				
<i>No. LIHTC Units:</i>	6	5	10	9
<i>No. Mkt. Units:</i>	6	7	2	3
End of Year 2:	Recapture on 2 units	Recapture on 2 units	No recapture	No recapture

While there may be good intentions behind this rule, what becomes clear in speaking with property managers is that compliance is difficult. Unit availability depends upon the unpredictable nature and needs of tenants. Managers cannot move tenants around like chess pieces in order to comply with Section 42. Even if they wanted to do so in order that the unit mix remain

in compliance, it may not be possible with existing qualified tenants. As mentioned earlier, once a tenant moves out of one LIHTC apartment, s/he has to qualify as s/he did initially. If a tenant has been in a unit for several years and has had some life changes, s/he could very easily go above the income limit.

UNIT MIX

Unit mix is a housing policy that is a function of the marketplace as well as the LIHTC program itself. It cuts across all levels of the process in terms of influencing the player's actions. While the LIHTC, or any housing program for that matter, has the ability to promote an economic mixture of households through its rules and regulations, the actual feasibility of mixing is really dependent upon the micro-economy in which the project is located. The issue is complicated and what may be "good" housing policy does not always coincide with the tax policy at hand.

Studies have shown that projects with an economic integration of households are more "successful" with higher satisfied tenants than those with 100% low income tenants.³⁶ Moreover, "housing developments built solely for the poor have been criticized because they isolate the poor both geographically and socially."³⁷ The advantage with mixed income developments is that the overall project is better quality and there can be less opposition to the projects. The developer must build for the market in order to attract market rate tenants who have numerous options. The site, design, and workmanship are of a higher standard and the result is better housing for low income households. Furthermore, the "not in my back yard" syndrome can often be avoided in

³⁶William Ryan, Allan Sloan, Mania Seferi and Elaine Werby, "All in Together: An Evaluation of Mixed Income Family Housing," *Summary Report of the Massachusetts Housing Finance Agency*, (January 24, 1974), p. 14.

³⁷Keyes and DiPasquale , p. 9.

mixing low income and market rate tenants. As a result, more housing can be built.

The benefits of mixed income housing have been recognized and promoted, at least verbally, by the federal government.

The federal housing policy of the 1980's resulted in the concentration of the poorest of the poor in festering inner city ghettos. To correct that situation, the Clinton Administration wants to mix income levels within neighborhoods.³⁸

However, to date, the structure of many of the federal programs for affordable housing have promoted 100% low income housing. The LIHTC is no different. The IRS stipulates a minimum number of affordable units, but no maximum number of LIHTC units. Since credits can only be applied to those units in the project which are designated as low income, from a financial point of view, it is advantageous to have 100% low income units. The more tax credit units in a project, the more capital can be raised.

Some of the rules designed to prevent the misuse of tax credits by businesses -- such as allowing tax credits only on individual apartments rented to the poor, not on the entire housing development -- inadvertently contradict national housing policy goals, chief among them economic integration.³⁹

While the intention behind the LIHTC may not have been to promote economic integration within projects, studies have shown that the 4% credit is more conducive to mixed income development than the 9% credit. The

³⁸Stanfield, p. 1071.

³⁹Stanfield, p. 1069

Massachusetts Housing Finance Agency (MHFA) examined the tradeoff between taxable financing with the 9% credit and tax exempt financing with the 4% credit. They found that with “more low income units and higher rehabilitation basis, taxable financing and the 9% credits became more attractive.”⁴⁰ Mixed income developments worked better with the 4% credit because on a unit-per-unit basis, the difference between the 4% and 9% credits does not make up for the lower debt service with tax-exempt financing.

In terms of the management perspective, 100% tax credit projects could be considered "easier" to manage. The manager does not have to keep track of which units are market rate and which are LIHTC. When a tenant moves out, there is no need to determine if the unit should be marketed as market rate or LIHTC based upon the next available unit rule. The problem is whether or not there is a large enough pool of applicants to fill the units. In this respect it is the market influencing this issue. Due to the stringent rent and income caps on LIHTC units, there is a narrow window of qualified households without subsidies who are eligible for the units. The economic health of the market area can greatly influence the type and number of households attracted to the development.

Looking at original qualification, income and rent levels, recertification as well as unit mix and building requirements for the LIHTC program, offers an indication of the intense administrative aspects involved for the property manager. Tenant certification has to occur on a monthly basis in order to assure that incomes qualify, rents are not too high and that the unit mix is correct. The IRS is concerned with *continuous* compliance of every project, not

⁴⁰Massachusetts Housing Finance Agency Study, May 13, 1993, p. 2.

just aggregate compliance. That is, a project must be in compliance with Section 42 of the code every day of its affordable life, not just at year-end when reports are filed. The threat of recapture is always present.

The issue, of course, is that the more time that is devoted to the administrative requirements of the LIHTC, the less time that is spent in actually managing the property. If the property suffers, then so does the project as a whole. Take, for example, an unsophisticated property manager who did not fully understand the program and did not adequately manage the property. The LIHTC as a subsidy program could appear unsuccessful should such examples prevail. This case is extreme, but not out of the realm of possibility. On the one hand, the participants become more familiar and experienced with the use of LIHTC's; on the other, more players enter the game who could be inexperienced and unsophisticated.

CHAPTER FIVE: CASE STUDIES

Having discussed the significant issues surrounding the impact of the LIHTC mechanics and process, it is important to explore them in actual cases; to examine how the issues discussed in Chapter Four "play out" on the ground. As discussed earlier in this thesis, there are two very different types of tax credit deals: inner city and suburban. For purposes of this paper, suburban deals refer to projects located in less dense, non-urban environments, not just areas on the periphery of metropolitan centers. Urban deals are those which are in "impacted" areas with populations of approximately 50,000 or more.

Within each of these categories the market greatly influences the feasibility and general character of the project. A strong market with high median incomes will support a different project mix than a weak or declining market with low median incomes. While the market influences on the project can occur independently of the LIHTC issues, there are some problems that arise which are complicated by the tax credit program.

This chapter will examine two affordable housing developments in Massachusetts to illustrate both the market and LIHTC impacts at the project level. Both projects were developed by a Boston based non-profit developer. One is located in a weak urban area, "Radcliffe," MA, while the other is in a suburban town, "Chiswick," MA, with a strong housing market.⁴¹ While the projects differ in terms of unit mix because of their market locations, there are some LIHTC and subsidy issues which are similar. Before examining

⁴¹Though the projects are existing, the names of the towns and the projects have been changed.

the two cases, one should have an understanding of the basic differences between suburban and urban projects.

SUBURBAN V. URBAN PROJECTS

Many suburban deals are located in areas with low construction costs and high median incomes. The capital structure is typically 50% debt and 50% equity. While still subject to the complexities of the LIHTC guidelines, these deals tend to be straightforward and undertaken by for-profit developers. Often ranging from 100 - 200 units, due to space availability, these projects also tend to be larger than their urban counterparts.

In Massachusetts, for-profit sponsored "suburban" LIHTC projects are less common than their urban counterparts. In 1993 only 22% of the State projects were over 100 units, up from the previous year of 13%. Of the 9 projects of this type, only 3 were constructed by for-profit developers and 3 were in non-urban environments.⁴²

There are several reasons which explain the Massachusetts situation. Construction costs are higher so that financing is more complicated. Tax credits cannot provide 50% of the equity, but more in the realm of 30%. The projects are smaller because land is not abundant. In fact, per the guidelines outlined by EOCD, rehabilitation is favored over new construction due to the amount of existing stock available for housing. Thus, based upon the smaller size of older buildings, project size is limited. Furthermore, projects receive "bonus points" in the evaluation process if they are located in areas in which EOCD, the State allocating agency, deemed "under-served and/or in areas with

⁴²Source: Executive Office of Communities and Development

relatively high concentrations of affordable housing needs."⁴³ The majority of these locations in Massachusetts are former industrial towns. The areas are dense and not conducive to large scale projects.

The suburban project discussed in the following case study is somewhat of a hybrid. It follows the suburban model in its location and tenant mix. However, it is not as large, having only 60 units versus over 100. Furthermore, due to the fact that it was built in Massachusetts, construction costs were high and the financing structure complex. The urban project follows the more typical model described with its weak housing market and very low income tenants.

"RADCLIFFE", MA

Background

A former mill town "Radcliffe", MA has a population of over 44,000 people. The streets surrounding the six-building scattered site, "Radcliffe Commons", in the South Radcliffe neighborhood, are lined with four-story brick apartment buildings. Open space consists mainly of empty lots and an overgrown park. The somewhat deserted commercial district is located about one-half mile from the development, though there is a grocery and a liquor store down the street.

Six years ago there was little interest in redeveloping the South Radcliffe neighborhood for residential use. Arson was rampant in the area and there was talk of letting the neighborhood burn down and turning it into a light industrial park. A neighborhood group, wanting to maintain the area for the existing Latino population, thwarted the plan. Quality affordable housing was

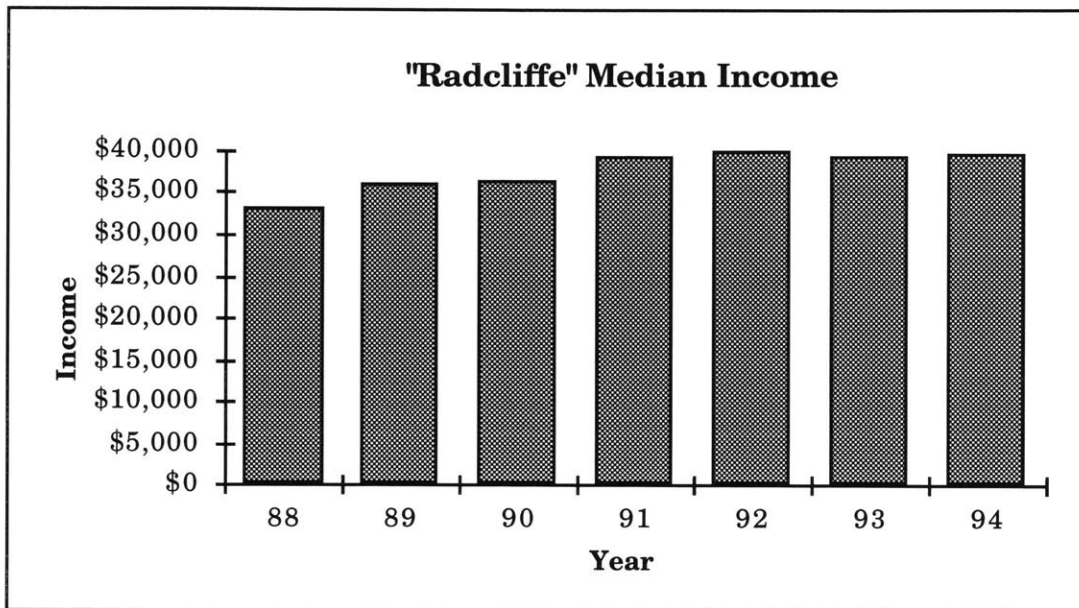
⁴³EOCD, *1994 Allocation Plan for the Low Income Housing Tax Credit*, Commonwealth of Massachusetts, (April 1994), p. 20.

not prevalent and thus there were few options for a household on a fixed income that wanted, or had, to remain in the area.

While today, rehabilitation and new construction are apparent, perhaps implying recovery, the area is still economically weak. Where there were once healthy industrial mills, there are now empty buildings. No other industry has replaced the former mills. The SMSA median income of \$39,600 has remained relatively flat in the past four years. In 1994, there was a \$100 increase, having fallen the previous year. (See Figure 5.1) Furthermore, FMRs have also decreased or remained relatively flat since 1990. (See Figure 5.2) The previous decline in median income and FMRs mandated a recent refinancing effort for Radcliffe Commons.

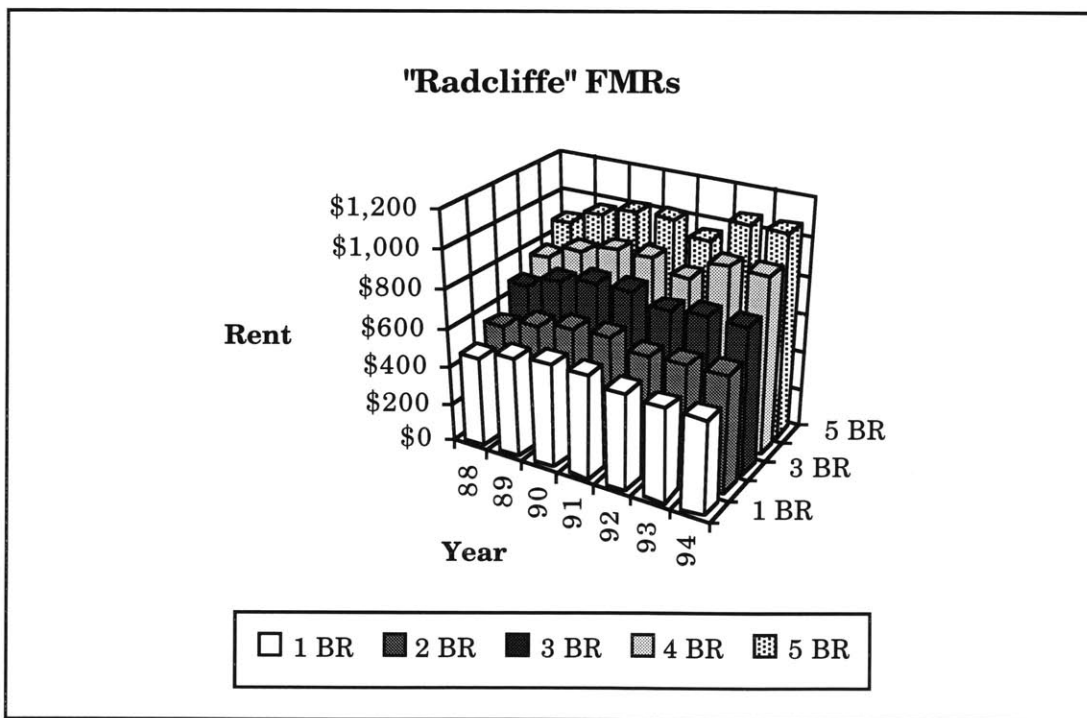
The South Radcliffe area provides an arena in which to examine LIHTC and subsidy issues related to housing in a weak economic area. Rent, income, unit mix are all impacted not only by the three primary components: the LIHTC program, the subsidies and the housing market.

Figure 5.1



Source: The Department of Housing and Urban Development

Figure 5.2



Source: The Community Builders, Boston, MA

"Radcliffe Commons"

Renovated in 1988, Radcliffe Commons is a 48-unit project of which 38 units are designated as LIHTC. The ten remaining non-LIHTC units are designated low-moderate income by the MHFA. (See Figure 5.3) Though not all the units are LIHTC, Radcliffe Commons is not a mixed income development in the sense of having "true" market rate tenants. That is, no household earns above the SMSA median income. The apartment mix in terms of size and LIHTC or non-LIHTC is spread evenly over the four scattered site buildings.

Figure 5.3

Radcliffe Commons						
No. BR	FMR Rent	No. Units	Low-Mod Rent	No. Units	LIHTC Rent⁴⁴	LIHTC Util. Allowance
1	\$481	1	\$400	0	NA	NA
2	\$608	5	\$450	7	Varies	\$96
3	\$759	4	\$500	22	Varies	\$107
4	\$931	0	NA	8	Varies	\$119
5	\$1070	0	NA	1	Varies	\$132

Income

Income eligibility for LIHTC apartments was and is not a significant problem in Radcliffe since the majority of people in this neighborhood are well below the median income cap. The SMSA median eligible income for a family of four is \$23,760. On a per person basis this equates to \$5,490 per year. The actual figures at Radcliffe Commons are significantly lower. The average household size is four people, with the median income being \$10,335. This equates to \$2,231 per year on a per person basis.

⁴⁴Note that in 1990, the method for calculating LIHTC rent changed. Before 1990, rents were determined by how many people occupied an unit. Thus, a family of 4 in a 2 bedroom apartment would pay a different rent than a family of 6 in the same apartment. Today, rent is based upon the size of the unit, not the size of the household. Since this project originated in 1988, it operates under the pre-1990 rent guidelines.

According to an on site property manager, "It is hard to find people in this neighborhood who are over income. It is more difficult to fill the market rate units than the tax credit." There is a limited population for these units. Since rents on the non-LIHTC apartments are higher than the LIHTC rent caps, in the South Radcliffe neighborhood, it is almost certain that a household would need rental assistance to afford the market rents. An examination of the rent roll reveals the fact that four of the five households in the occupied market rate units pay less than 30% of their income towards rent. The implication being that there is either sufficient income to pay the entire amount without assistance or they have assistance. There is one case where a household is paying over 70% of its income towards rent. The explanation being that it experienced a decrease in income while rent increased. The household has no rental assistance, but has adequately proven an ability to pay the rent.

Ironically, households in the LIHTC apartments, on average, pay more than 30% of their income towards rent. They have rental assistance, but if it is in the form of MRVP vouchers, then this situation occurs. MRVP vouchers only pay a fixed sum rather than filling the gap between 30% of the tenant's income and the rent. On the one hand the low income tenants benefit because they have housing; on the other, they still pay a significant percentage of their income towards rent.

Rent

Before continuing an in depth discussion on income, rent caps should enter the equation. Although income eligibility is not a significant issue at Radcliffe Commons, there is a problem with "glass ceilings". The majority of tenants

would not be able to afford the rents without some form of rental assistance. Everyone in the LIHTC apartments, and some in the low-moderate units, have rental assistance either in the form of Section 8 or MRVP. Tenants with Section 8 or *project* based MRVP certificates only pay 30% of their income towards rent. Those households with *tenant* based MRVP vouchers could be paying more than 30% of their income towards rent due to the reasons described above. In fact, there are ten households paying up to or more than 50% of their income towards rent and utilities. (See Figure 5.5)

Rents and incomes in the LIHTC units are administratively intensive. The LIHTC rent caps must be coordinated with Section 8 and MRVP. In all, the manager must keep track of eight different rent schemes. (See Figure 5.4) On Section 8 units, rent can be collected up to the FMR, which is usually higher than LIHTC rent caps, without violating Section 42. As described earlier, MRVP is a different situation. On MRVP apartments, an owner or manager can only collect the stipulated rent on the apartment whether it is LIHTC or market rate. Typically, MRVP rents are based upon MARs. However, at Radcliffe Commons, there are rent caps on all apartments due to either LIHTC or MHFA regulations. Although the MARs for the non-tax credit units are higher than the capped amounts, the higher rent cannot be collected due to MRVP guidelines. A development such as Radcliffe commons, could not exist if tenants did not have rental assistance. However, it is clear that the manager must constantly be aware of different rent limitations. LIHTC tenants are of special concern because they could easily pay over the rent cap if they had portable MRVP vouchers instead of Section 8.

Figure 5.4

Radcliffe Commons Rent Schemes	
<u>LIHTC</u>	<u>Low-Moderate</u>
No Assistance	No Assistance
Section 8	Section 8
Tenant based MRVP	Tenant based MRVP
Project based MRVP	Project based MRVP

Tenants require rental assistance to be able to afford the rents. Section 8 certificates are preferable over MRVP for both tenants and owners or managers. Tenants are guaranteed to pay only 30% of their income and owners and managers can receive higher rents on both the LIHTC and non-LIHTC units. FMRs, the contract rent received under Section 8, are typically higher than the LIHTC rent caps. At Radcliffe Commons, FMRs are also higher than the rents specified on the low-moderate units. In either situation, the owner and/or manager is better off accepting a Section 8 certificate holder due to the higher contract rent. The problem, of course, is that Section 8 certificates are difficult to acquire since the government is no longer issuing new ones.

For example, a 2-bedroom low-moderate unit commands a rent of \$530. The FMR rent is \$608 for the same unit. The owner collects the additional \$78 from the government. (See Figure 5.3) A similar scenario exists for a LIHTC apartment. The rent on a 2-bedroom unit for three people has a maximum eligible rent of \$533, as established under Section 42 guidelines. The overage in this case is \$75. For the LIHTC apartments, the additional income varies depending upon the number of people in the apartment. (See footnote 44)

The problem is not only the complexity of the various rental assistance programs, but also the financial health of the project. The market greatly influences the effect of the rental assistance. In a weak economy when FMR's do not increase then neither does operating income. However, operating expenses, inevitably, do increase. Owners and managers are restricted in their ability to increase rents to accommodate their shortfall due to the limits set by the subsidy programs. This situation is true for both LIHTC and non-LIHTC rents.

Financing

One of the primary financing sources for Radcliffe Commons was SHARP funding, a state run program which could be utilized with the 9% LIHTC credit. SHARP was a debt service subsidy which provided a maximum amount in the first year of operation and then decreased a percentage each year thereafter based upon income and expense assumptions in the operating pro forma. It has since been eliminated as a program, though not on the project. The problem in Radcliffe was that as SHARP was decreasing, so was operating income, yet expenses were increasing. The gap widened each year. In 1992 and 1993 the property lost \$22,000 and \$53,000 respectively.

This scenario illustrates the conflict between LIHTC rents and financing. As discussed earlier, there is a limited number of funds which can be used in conjunction with the LIHTC and still receive the 9% credit. At the same time, the limited source of income hinders the financing methods.

LIHTC projects work better in areas where income is relatively high -- allowing for high project rents -- and construction, land and operating costs relatively low -- thus reducing debt service and operating cost.⁴⁵

⁴⁵*Evaluation of the Low Income Housing Tax Credit Final Report*, (February 28, 1991), p. 2.

The market has a significant impact on the financing. The LIHTC is dependent upon additional sources of financing -- both development and operating subsidies. The subsidies utilized at Radcliffe Commons -- SHARP, Section 8 and MRVP -- function under expectations of growth. It is assumed that incomes and rents will increase along with expenses. The subsidies are meant to fill a gap either for the tenant or the owner. However, as the market weakens, the gap grows wider.

In one sense this scenario is no different than the market rate rentals. Development and operating pro formas are based on expectations of growth. The difference is that market rate owners are not bounded by rent and income caps. Although there are external control mechanisms, such as rent control and market demand, rents can be increased on an annual basis, thereby by meeting operating expenses and debt service requirements. In affordable housing where a significant portion of the financing is government funding, when the gap widens then the only method of filling it is through additional government sources. The LIHTC cannot accommodate this problem.

Unit Mix

Filling the units in the first three years was relatively easy for several reasons. Radcliffe Commons was newly renovated, making it a desirable place to live. Income eligibility for LIHTC units was not a problem. Furthermore, at that time, the management company was one of the only in the area accepting rental assistance certificates. (Now it is illegal to refuse eligible certificate holders for LIHTC apartments.) There were not many options for quality affordable housing.

Since 1988, the South Radcliffe neighborhood has undergone some fundamental changes. Although the neighborhood has improved aesthetically, it has not done so economically. Attracting a larger pool of diverse tenants is a challenge, if not impossible. In fact, the several newly constructed developments in the area creates a competitive atmosphere for finding tenants. Since the market is "soft", the majority of owners are accepting rental vouchers for both LIHTC and non-LIHTC units. Thus, for older developments such as Radcliffe Commons, it is harder to find tenants in general.

A market such as South Radcliffe could not support an "ideal" mixed income development where 1/3 of the units were market rate, 1/3 moderate and 1/3 low income. The affordable housing was built out of need for the existing residents. Radcliffe does not have a strong enough economic pull to attract a larger pool of applicants. Neither high nor low income households from other areas, especially certificate holders, have a reason to move to South Radcliffe. It is evident from a review of the South Radcliffe rent roll that what is supposed to be a "mixed income" development is not a reality. The project median incomes are well below the eligible median income. Due to the market, non-LIHTC rents are very close to LIHTC rents. LIHTC participants have indicated that,

You have to look at the neighborhood and know your market. Our neighborhoods are exclusively poor and middle income people are not going to come here to live. If we did a mixed income project it would probably go belly up.⁴⁶

In these situations, where the project is supposed to cater to "mixed income", but there is a negligible difference between tax credit and non-tax credit rent,

⁴⁶Jeffrey Gibney, Executive Director South Bend Heritage Foundation, as included in Stanfield, p. 1071

MHFA imposes requirements. They want to see a minimum 10% differential between market and LIHTC rents. Thus, the sponsor or developer has to find additional subsidy to lower LIHTC rents in order to maintain a mixed income project.

The irony is that even with a stronger market, South Radcliffe would not fair much better. In a stronger market where incomes were higher, and rental assistance more prevalent, then tenants would have the option to move to more desirable neighborhoods. Rather than the existing intra-neighborhood competition, there would be inter-neighborhood or area competition for tenants.

Another consideration is tenant mobility. Those tenants who have Section 8 certificates have many options since they will always pay only 30% of their income no matter how high the rent. They are also in high demand by owners and managers of LIHTC units because FMRs can be collected rather than the lower LIHTC rents. These tenants still remain in an area such as South Radcliffe despite the depressed neighborhood. This situation indicates that there are other variables influencing their decisions other than market supply and demand.

**Figure 5.5
Radcliffe Commons Rent Roll**

Unit No.	Unit Size (GSF)	No. BR	Hsehld Size	Max. Elig Inc	Hsehld Income	Income/ Person	Max. Elig Rent	Hsehld Gross Rent	Rent to Inc. Ratio
1	950	3	2	\$18,960	\$6,581	\$3,291	\$474	\$347	63.27%
2	950	3	3	\$21,300	\$9,648	\$3,216	\$533	\$568	70.65%
3	950	3	5	\$25,620	\$13,109	\$2,622	\$641	\$566	51.81%
4	950	3							
5	950	3	3	\$16,620	\$6,437	\$2,146	\$416	\$175	32.62%
6	950	3	4	\$23,700	\$14,560	\$3,640	\$593	\$340	28.02%
7	950	3	3	\$21,300	\$6,468	\$2,156	\$533	\$268	49.72%
8	VACANT								
9	757	3	6	\$27,480	\$14,162	\$2,360	\$687	\$305	25.84%
10	1162	4	5	\$25,620	\$8,640	\$1,728	\$641	\$187	25.97%
11	757	3	3	\$21,300	\$6,468	\$2,156	\$533	\$268	49.72%
12	1162	4	5	\$25,620	\$10,952	\$2,190	\$641	\$495	54.24%
13	757	3	3	\$21,300	\$6,468	\$2,156	\$533	\$268	49.72%
14	1162	4	6	\$27,480	\$9,768	\$1,628	\$687	\$184	22.60%
15	757	3	5	\$25,620	\$13,364	\$2,673	\$641	\$298	26.76%
16	VACANT								
17	1162	4	6	\$27,480	\$9,768	\$1,628	\$687	\$196	24.08%
18	757	3	4	\$23,700	\$12,281	\$3,070	\$593	\$273	26.68%
19	1162	4	7	\$29,400	\$10,872	\$1,553	\$735	\$212	23.40%
20	757	3	5	\$25,620	\$18,821	\$3,764	\$641	\$607	38.70%
21	1162	4	6	\$27,480	\$9,768	\$1,628	\$687	\$299	36.73%
22	757	3	4	\$23,700	\$8,616	\$2,154	\$592	\$310	43.18%
23	1162	4	7	\$29,400	\$11,064	\$1,581	\$735	\$207	22.45%
24	757	3	3	\$21,300	\$6,460	\$2,153	\$533	\$138	25.63%
25	683	2	4	\$23,700	\$20,512	\$5,128	\$593	\$457	26.74%
26	683	2	3	\$21,300	\$27,897	\$9,299	\$533	\$546	23.49%
27	683	2	2	\$18,960	\$9,797	\$4,899	\$474	\$223	27.31%
28	683	2	3	\$21,300	\$32,906	\$10,969	\$533	\$482	17.58%
29	683	2	2	\$18,960	\$20,219	\$10,110	\$474	\$473	28.07%
30	683	2	1	\$16,620	\$22,000	\$22,000	\$416	\$443	24.16%
31	683	2	1	\$16,620	\$8,959	\$8,959	\$416	\$341	45.67%
32	683	2	3	\$21,300	\$6,902	\$2,301	\$533	\$257	44.68%
33	677	1	1	\$16,620	\$25,812	\$25,812	\$416	\$435	20.22%
34	1333	5	8	\$31,260	\$16,445	\$2,056	\$782	\$329	24.01%
35	1005	3	5	\$25,620	\$8,038	\$1,608	\$641	\$357	53.30%
36	1005	3	3	\$21,300	\$14,539	\$4,846	\$533	\$351	28.97%
37	1005	3	4	\$23,700	\$8,136	\$2,034	\$593	\$310	45.72%
38	1005	3	4	\$23,700	\$7,536	\$1,884	\$593	\$295	46.97%
39	1005	3	4	\$23,700	\$16,498	\$4,125	\$593	\$498	36.22%
40	1005	3	4	\$23,700	\$6,468	\$1,617	\$593	\$126	23.38%
41	950	3	6	\$27,480	\$18,133	\$3,022	\$687	\$509	33.68%
42	VACANT								
43	950	3	6	\$27,480	\$14,213	\$2,369	\$687	\$292	24.65%
44	VACANT								
45	950	3	4	\$23,700	\$6,468	\$1,617	\$593	\$146	27.09%
46	683	2	3	\$21,300	\$6,468	\$2,156	\$533	\$138	25.60%
47	950	3	6	\$27,480	\$22,587	\$3,765	\$687	\$517	27.47%
48	683	2	5	\$25,620	\$13,584	\$2,717	\$641	\$546	48.23%
Average:					\$12,753	\$4,251			
Median:					\$10,872	\$2,360			

Note: Shaded area signifies a LIHTC unit

"CHISWICK", MA

Background

A contrast to South Radcliffe, is "Chiswick," MA. With a population of 6,000, the upper-middle class community sits on the outskirts of Boston. It is essentially a bedroom community with few services and most of its inhabitants commute into Boston or adjacent towns for jobs. Except for the 60-unit, mixed income Dryver's Orchard project and a HUD 202 elderly development, there is virtually no rental housing in the town. The majority of dwellings are single family houses with 2-acre zoning and median prices of \$235,400.⁴⁷ Apple orchards and four golf courses constitute the open space.

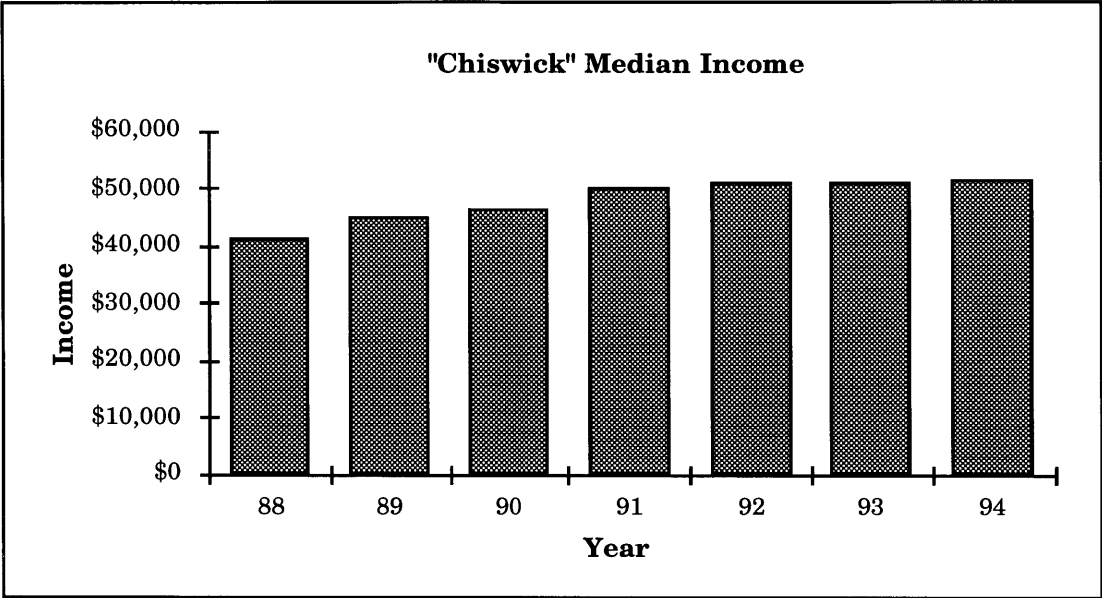
One of the reasons for locating Dryver's Orchard in Chiswick was to fulfill the Massachusetts requirement that 10% of the housing in each municipality be affordable. A local family decided to sell part of their sheep farm at a reduced rate in order to provide affordable housing for the changing local market. For families who wanted smaller quarters, or young families, who wanted to remain in the area, there were few options other than the large, expensive single family residences. This project met opposition from many parties along the way who did not want low income housing in "their backyard." Today there is still some resistance, but the project has only a 4% vacancy and substantial waiting lists.

While Chiswick appears to be the polar opposite of Radcliffe, it has experienced similar rent and income trends. The SMSA median income is \$51,300 for a family of four. Though significantly higher than Radcliffe's, it has remained

⁴⁷Edith Hornor, *Massachusetts Municipal Profiles, 1993-1994*, (California, Information Publications, 1993),

relatively flat since 1991. (See Figure 5.5) FMRs have followed suit, having a significant impact on operating income. (See Figure 5.6) The difference between these two projects is that the overall economy has a different effect on their micro-economies.

Figure 5.5

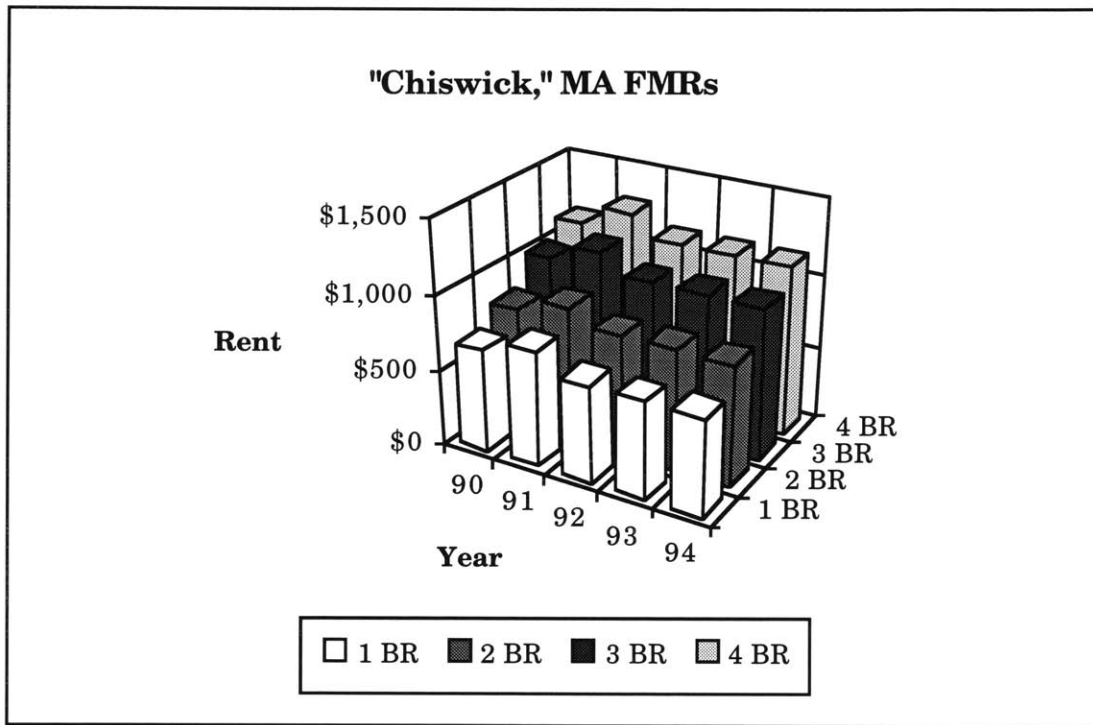


Source: Department of Housing and Urban Development

Dryver's Orchard

Dryver's Orchard is a classic mixed income development with market, moderate and low income tenants. Doctors and vice presidents from international computer firms are situated next door to recent arrivals from homeless shelters. The ten separate buildings that make up the development, sit on a hill overlooking a former sheep farm. There are thirty LIHTC units. The other half of the development is made up of eight moderate income apartments and twenty-two market rate apartments. (See Figure 5.7)

Figure 5.6



Source: The Community Builders

Figure 5.7

Dryver's Orchard								
No. BR	FMR Rent	No. Units	Mkt. Rent	No. Units	Mod.	No. Units	Max. LIHTC Rent	LIHTC Utility Allow. ⁴⁸
1	\$637	6	\$750	3	\$615	3	\$576	\$36
2	\$796	13	\$890	3	\$665	20	\$691	\$51
3	\$995	3	\$980	2	\$715	7	\$799	\$58

Income and Rent

As illustrated in previous sections of this thesis, income and rent are integrated components. It is difficult to discuss one without including the other. In terms of LIHTC income and rent, Dryver's Orchard offers a classic example of the "glass ceiling" problem. LIHTC units are reserved for households earning at, or under, 60% of the SMSA gross median income per Section 42 guidelines.

⁴⁸Note: Utilities are already included in rent numbers shown.

However, in order to comfortably afford the rent, a household has to be at the upper limits of income eligibility or have rental assistance. The problem is magnified in an area such as Chiswick where the median income is significantly higher than an area such as Radcliffe. The SMSA median income is \$51,300 for 1994. For a family of four to qualify for an LIHTC unit, it can earn no more than \$30,720 in a "40/60" project. While the household can earn more than the family in Radcliffe and still qualify for the LIHTC apartment, rents are also higher since they are based upon median income. The need for rental assistance for the low income family (under 50% of the median income) is absolutely necessary in order for them to live in such a unit.

Recognizing this predicament, and wanting to enable low income households to live in Dryver's Orchard, the developer and MHFA structured the deal so that LIHTC units would be in two separate categories.⁴⁹ There are 22 low income units designated for tenants with vouchers or certificates. Should a prospective eligible tenant for one of these units not have a voucher or certificate, the manager can apply to MHFA and EOCD for back-up assistance. The remaining eight units are reserved for low-moderate tenants with no vouchers.

An examination of the rent roll reveals that all households in the eight low moderate LIHTC units are at, or just under, the eligible income. Three of the households are just over the limit, suggesting that they had originally qualified, but have since received raises. Per Section 42, a household can be over the limit as long as it originally qualified. (See Figure 5.9)

⁴⁹MHFA, in addition to being the first mortgage holder, usually has significant input in structuring affordable housing deals in Massachusetts. They will often stipulate the type of income mix in a project.

Anecdotal evidence suggests that the low-moderate tenants are the most difficult to find. There is a narrow window of tenants who qualify since rental subsidies cannot be applied to these rents. Not only is there the LIHTC constraint, but also the manager at this property does not allow a household to spend more than 40% of its income towards gross rent.⁵⁰ For example, a family of three, at Dryver's Orchard, can have a maximum household income of \$27,660 to qualify for a LIHTC unit. Rent on a two bedroom apartment is \$691. With these parameters, the minimum amount the family can earn and still qualify for the apartment is \$20,730, a window of \$6,930. (See Figure 5.8) With one person working, the minimum hourly wage is \$10.30 per hour. No one earning minimum wage or who is on a fixed income could afford the apartment. This example illustrates not only how rigid the LIHTC program is, but the thin margin on which it operates. Without rental assistance, the eligible window is small.

Figure 5.8

LIHTC Family at Dryver's Orchard With No Rental Assistance	
<i>Family Size:</i>	3
<i>Apartment Size:</i>	2
<i>Median Income:</i>	\$51,300
<i>Eligible Income @ 60%:</i>	\$27,660
<i>Rent (monthly):</i>	\$ 691
<i>Yearly Rent / 40%</i>	<u>\$8,292/.4</u>
<i>Min. Eligible Income:</i>	\$20,730
<i>Eligible Window:</i>	\$6,930

⁵⁰The 40% applies to when a household originally applies for an apartment. There are some households which do pay more than 40% of their income towards rent. In these circumstances there are two plausible explanations: 1) Rents increased and income did not; or 2) rents remained the same and income decreased.

Similar to Radcliffe Commons, the LIHTC tenants at Dryver's Orchard pay, on average, a greater percentage of their income towards rent than the non-LIHTC apartments. Forty-six percent of the LIHTC households pay more than 30% compared to 29% of the non-LIHTC households. It is ironic, in that these apartments are reserved for low income households, who do not have as much leeway in their income.

Since Dryver's Orchard is a truly mixed income development, with market, moderate and low income households, it can be more complicated monitoring unit equilibrium than at a project such as Radcliffe Commons. Not only are there the MRVP voucher households, which pose the similar concerns as they do at Radcliffe, but there are the LIHTC tenants with no rental assistance. They have to be closely monitored in terms of the "next available unit" rule. Should these tenants exceed 140% of the eligible income, then the next available unit must be designated as LIHTC since the original one no longer qualifies. Since the eight households without vouchers entered the complex at the limit, so to speak, and few of them have now exceeded the limit, it is a plausible scenario.

Financing

Although Chiswick is a stronger market area than Radcliffe, it has similar financing problems. In addition to tax credits, Dryver's Orchard has an MHFA loan and SHARP subsidy. The SHARP subsidy was to remain level for the first three years and then decrease under the expectation that operating income would increase at a constant rate. In addition, a portion of the syndication proceeds were in a pool to fill the gap in year eight when the SHARP subsidy phased out. However, similar to Radcliffe, Chiswick FMRs

have decreased since 1990. (See Figure 5.6) Furthermore, market rents, which typically are not subject to such restrictions, in this case are limited by MHFA. MHFA has to permit the manager/owner to increase rents on all market rate units. This year there will be a 5% rent increase, the first since the project opened in 1991.

Even a project in a strong market, where there is a low vacancy and higher rents suffers similar financial gaps. The difference is that Dryver's Orchard, due to its desirable neighborhood and strong school system, will always attract a wider pool of tenants than Radcliffe Commons.

Unit Mix

Dryver's Orchard is a primary example of a mixed income development with complete economic integration. While the deal was consciously structured to cover the range from low to high income households, the feasibility is dependent upon the market. This same mix would not work in Radcliffe. Due to its desirable location both market rate and lower income households are willing to move to Chiswick, thus expanding the pool of potential tenants. There are, however, a few issues which warrant discussion.

Dryver's Orchard has an inverse problem to Radcliffe Commons. That is, market rate tenants are easier to obtain than low income ones. There are several explanations for this situation. One part of the problem has to do with work and transportation. Dryver's Orchard is located on a steep hill in a town with no public transportation or industry. Many of the lower income tenants do not have their own car, thus commuting to a job in another town is difficult.

There are some situations where households commute together thereby minimizing the dilemma.

The other consideration is opportunities for market rate versus low income tenants. Market rate units turnover more frequently than do low income ones, whether or not they are LIHTC apartments. Households which can afford the market rate units tend to have more options given their higher incomes. Apartments such as Dryver's Orchard often serve as transitional housing while households explore other opportunities in the area. Even though market rate units turnover more often they are easier to fill since there are no income eligibility requirements.

Households in LIHTC units, especially those without vouchers, tend to stay put. Their options are limited particularly in areas such as Chiswick where there is little rental housing at all, let alone affordable. There is a high demand for these units because of the desirable location. The waiting list is long and the managers receive at least ten inquiries per week regarding the low income units. The problem is that the households with no vouchers do not vacate often. By the time there are space for those on the waiting list, the potential tenants may not be income eligible. Here is another case where the market plays an integral role. Some potential tenants were on a waiting list for two years. During that period, their income increased, but the SMSA median income decreased making them ineligible for a LIHTC unit. While the manager can still turn to the remainder of the waiting list, s/he may have to resort to advertising for the unit just as they would for a market rate. The difference between the two is that there is a limited applicable audience.

**Figure 5.9
Dryver's Orchard Rent Roll**

Unit No.	Unit Size (GSF)	No. BR	Hsehd Size	Max. Elig Inc	Hsehd Income	Income/ Person	Hsehd Gross Rent	Rent to Inc. Ratio	Market Type
1	1192	3	4		\$32,000	\$8,000	\$773	28.99%	Moderate
2	964	2	1		\$49,733	\$49,733	\$926	22.34%	Fair Market
3	964	2	2	\$24,600	\$16,076	\$8,038	\$457	34.11%	MRVP
4	964	2	1		\$72,758	\$72,758	\$926	15.27%	Fair Market
5	964	2	3	\$27,660	\$8,347	\$2,782	\$278	39.97%	MRVP
6	1192	3	4	\$30,720	\$7,536	\$1,884	\$277	44.11%	MRVP
7	1192	3	3	\$27,660	\$5,508	\$1,836	\$138	30.07%	Sec. 8
8	964	2	2		\$30,000	\$15,000	\$941	37.64%	Fair Market
9	964	2	2		\$23,839	\$11,920	\$716	36.04%	Moderate
10	964	2	2	\$24,600	\$5,352	\$2,676	\$182	40.81%	Sec. 8
11	964	2	2	\$24,600	\$25,064	\$12,532	\$609	29.16%	Low-Mod
12	1192	3	3	\$27,660	\$29,496	\$9,832	\$684	27.83%	Low-Mod
13	1192	3	2		\$75,000	\$37,500	\$1,048	16.77%	Fair Market
14	964	2	2	\$24,600	\$5,352	\$2,676	\$128	28.70%	Sec. 8
15	964	2	4	\$30,720	\$31,200	\$7,800	\$706	27.15%	Low-Mod
16	964	2	2		\$48,036	\$24,018	\$941	23.51%	Fair Market
17	964	2	2	\$24,600	\$5,352	\$2,676	\$207	46.41%	
18	1192	3	3	\$27,660	\$5,832	\$1,944	\$128	26.34%	Sec. 8
19	1192	3	5		\$30,426	\$6,085	\$773	30.49%	Moderate
20	964	2	2		\$35,000	\$17,500	\$941	32.26%	Fair Market
21	964	2	3	\$27,660	\$21,670	\$7,223	\$691	38.26%	Low-Mod
22	964	2	3	\$27,660	\$10,397	\$3,466	\$257	29.66%	MRVP
23	964	2	1		\$35,568	\$35,568	\$941	31.75%	Fair Market
24	1192	3	3	\$27,660	\$27,431	\$9,144	\$581	25.42%	Sec. 8
25	1270	3	2		\$32,700	\$16,350	\$958	35.16%	Fair Market
26	964	2	2	\$24,600	\$23,845	\$11,923	\$609	30.65%	Low-Mod
27	964	2	2		\$29,836	\$14,918	\$941	37.85%	Fair Market
28	964	2	3	\$27,660	\$26,001	\$8,667	\$678	31.29%	MRVP
29	964	2	1		\$36,500	\$36,500	\$941	30.94%	Fair Market
30	964	2	2	\$24,600	\$2,736	\$1,368	\$85	37.28%	Sec. 8
31	VACANT								
32	1008	2	3		\$28,000	\$9,333	\$941	40.33%	Fair Market
33	964	2	3		\$29,614	\$9,871	\$716	29.01%	Moderate
34	964	2	2	\$24,600	\$19,269	\$9,635	\$447	27.84%	MRVP
35	964	2	2		\$55,204	\$27,602	\$851	18.50%	Fair Market
36	1192	3	5	\$33,180	\$11,475	\$2,295	\$412	43.08%	MRVP
37	736	1	1		\$30,000	\$30,000	\$736	29.44%	Fair Market
38	624	1	1		\$27,250	\$27,250	\$651	28.67%	Moderate
39	624	1	1	\$21,480	\$10,003	\$10,003	\$211	25.31%	Sec. 8
40	624	1	1		\$20,280	\$20,280	\$651	38.52%	Moderate
41	624	1	1		\$36,025	\$36,025	\$736	24.52%	Fair Market
42	624	1	1		\$25,400	\$25,400	\$786	37.13%	Fair Market
43	624	1	1		\$6,156	\$6,156	\$152	29.63%	Sec. 8
44	624	1	1		\$30,000	\$30,000	\$691	27.64%	Fair Market
45	624	1	1	\$21,480	\$7,656	\$7,656	\$248	38.87%	MRVP
46	624	1	1	\$21,480	\$19,788	\$19,788	\$533	32.32%	Low-Mod
47	624	1	1		\$28,000	\$28,000	\$736	31.54%	Fair Market
48	624	1	1		\$50,700	\$50,700	\$786	18.60%	Fair Market
49	1192	3	4	\$30,720	\$7,068	\$1,767	\$246	41.77%	MRVP
50	964	2	3	\$27,660	\$16,023	\$5,341	\$684	51.23%	Low-Mod
51	964	2	1		\$31,407	\$31,407	\$941	35.95%	Fair Market
52	964	2	3		\$28,478	\$9,493	\$716	30.17%	Moderate
53	VACANT								
54	964	2	2		\$35,612	\$17,806	\$941	31.71%	Fair Market
55	1192	3	3		\$30,000	\$10,000	\$1,048	41.92%	Fair Market
56	964	2	3	\$27,660	\$18,125	\$6,042	\$494	32.71%	Sec. 8
57	964	2	2		\$70,000	\$35,000	\$941	16.13%	Fair Market
58	964	2	2	\$24,600	\$11,336	\$5,668	\$187	19.80%	Sec. 8
59	964	2	4	\$30,720	\$15,600	\$3,900	\$684	52.62%	Low-Mod
60	964	2	2	\$24,600	\$4,224	\$2,112	\$128	36.36%	Sec. 8
					Average	\$25,712	\$15,877		
					Median:	\$26,626	\$9,852		

Note: Shaded area indicates LIHTC apartment

CHAPTER SIX: CONCLUSION

This thesis is an analysis of three factors which impact the property manager of an affordable housing development utilizing LIHTC financing. The first factor is the LIHTC program itself and its participants. Additional subsidies and their requirements is the second factor and the third is the housing market. The LIHTC program with its stringent regulations and array of players is a complex entity. To compound this already intricate relationship, additional subsidies with a separate set of demands must be incorporated to make an LIHTC project feasible. These factors in their own right are difficult to manage, and the reality of the housing market further complicates the situation. The result of this complex relationship is an administrative nightmare for the manager and a detriment to the health of the project.

The LIHTC accomplished its goal of providing affordable housing, having built over 600,000 units to date. This number is significant not only in terms of affordable rental apartments, but it also has a notable economic impact on the multi-family industry in general during a lull in the construction industry. Despite these accomplishments, what the program has also achieved is a level of complexity never before realized in the supply of low income housing.

The question is not so much whether the LIHTC is to be or not to be, and the return to HUD sponsored affordable housing a possibility. The HUD approach, though not abandoned all together, had sufficient opportunities to deal with the low income housing situation. Their programs, while not as complex as the LIHTC, also had their share of difficulties. However, federal resources are not available for deep subsidy production and tax incentives are the only game in

town. That being the case, the LIHTC program, in light of the need for subsidies and the influence of the market, should be modified in order to best meet its objective.

Each of the three primary factors impacting the LIHTC program have their own issues. The LIHTC program itself is rigid with copious rules and regulations set forth in the IRC. The additional subsidies, due to their own constraints, are not always adequate to accomplish their purpose of filling the gap either on the demand or supply side of the equation. The housing market fluctuates since it is a function of exogenous and endogenous economic variables. When the three interact, the players are left to pick up the pieces and attempt to put them back together to create a feasible project.

The case studies of Radcliffe and Chiswick illustrate the fact that two entirely different market areas can have similar problems due to the stringent requirements of the LIHTC program and additional subsidies. The similarities diverge somewhat as a result of the market. No matter what the state of the market, managers have to cope with the intense administrative duties of the LIHTC program itself. Rent and income caps as well as the use of subsidies, not only complicate the administrative duties, but also are detrimental to the health of the project no matter how strong or weak the market is. Both the LIHTC program and the additional required subsidies should be altered to operate not only more smoothly, but, more importantly, in the context of the market. The modifications could take the following form:

THE LIHTC PROGRAM

Rent and Income

The rigidity of the current method of calculating rent and income does not accommodate the realities of prospective tenants and complicates the responsibilities of the property manager. These two primary components -- rent and income -- of the LIHTC program are so established that there is a small window of people who qualify and can comfortably afford the rents without additional subsidy. Lower income tenants (those below the stipulated 50% or 60% of median income) must have rental assistance in order to comfortably afford LIHTC rents. Even then, with vouchers such as MRVP, households often pay more than 30% of their income towards rent and utilities.

As long as rents are tied to the maximum eligible income, this situation will occur. The following scenarios illustrate the problem. If the income cap was raised there would be a larger pool of eligible applicants. However, if the rents are still established via the same method, then the situation is exacerbated for the lower income households. Higher incomes mean higher rents using the present LIHTC calculations. Lowering the income limit, shrinks the eligible tenant pool and eliminates many working class households who can afford to pay the LIHTC rents, but have few options in the market. The only benefit to this scenario is for the lower income households who cannot afford the higher rents.

The requirements need to be more flexible in order to accommodate the needs of the prospective clientele as well as alleviate the onerous administrative tasks for the manager. If rents and incomes were disconnected then they could float with the tenant's needs. Income limits could be raised to increase the

applicant pool, but rents would no longer be linked to it. As long as there is a link between the two, the more there is a need for additional rental assistance.

The property manager is affected by the rent and income limits in terms of compliance and monitoring issues. As illustrated at Radcliffe Commons, the manager must track eight different rent schemes. S/he must be constantly aware of how much a household is paying so that there is no violation of the tax credit regulations. While the rental assistance subsidies are a necessity for the tenants, programs such as MRVP are not necessarily coordinated with the LIHTC. The shortcomings of the rental assistance programs do not justify the administrative hassles they bring the manager.

Administrative Simplification

The discussion of the LIHTC program has revealed the onerous administrative responsibilities required of the manager. Income certification, compliance monitoring, filing numerous reports demand a substantial amount of time and detract from the other intensive managerial duties. Simplifying these requirements would not be out of the question and should not diminish the effectiveness of the LIHTC program. It would, however, ease the manager's life to concentrate on the project itself, rather than its financing program.

SUBSIDIES

The use of subsidies is one of the hurdles at all levels of the process, be it from the supply or demand side of the equation. Subsidy sources are minimal and to complicate the situation, the LIHTC program limits which ones can be used in conjunction with the 9% credit. Furthermore, the subsidy sources that are available may not function successfully throughout the life of the project.

Massachusetts programs, such as SHARP and R-DAL are both influenced by the market. Rental assistance subsidies are almost mandatory for both the owner, in order to maintain a healthy cash flow, and the tenant to comfortably afford the rents. However, as illustrated in both Radcliffe Commons and Dryver's Orchard, the complications that occur for the manager as a result are tremendous.

The irony is that the government ends up spending money on either the supply side or the demand side. Should the project fall into financial difficulty, due to the way debt service and operating subsidies are structured, the government must step in to rescue the project. While the project survives, managers must still deal with coordinating the various rental assistance programs required by the tenants to remain in the units. One option is to restructure the debt service and operating subsidies to realistically meet the needs of the project's operating income. Another option is for the government to improve the rental assistance programs, so they more accurately meet the needs of the tenants, are coordinated with the LIHTC program, and accommodate the inevitable operating income shortfall. Of course, another alternative is to return to basics and restructure the LIHTC program so that neither supply or demand subsidies are required.

THE MARKET

For the developer and syndicator financing the project is hindered not only by the limited funds available, but also, the market. Funds that are accessible, whether debt service or operating subsidies, all operate under the assumption of a strong economy. Development and operating pro formas are structured with expectations of growing operating income. However, as shown in both

Radcliffe and Chiswick these growth expectations are not always the reality. Chiswick's strong housing market, with little vacancy and "true" market tenants to compensate for the low income rents, has a financing gap just as the weak market in Radcliffe. Understandably, LIHTC rents are capped in order to serve the low income clientele. In Chiswick, the market rate rents are constrained by MHFA. In both cases owner's rely on rental assistance subsidies, primarily Section 8, where they can collect FMRs, to compensate for the lower LIHTC rents. These certificates are difficult to acquire since fewer are distributed each year.

While financing shortfalls occur in market rate housing, the solution in that case is determined by the market. Private investors can enter the scene and restructure the financing through equity or debt. In recent years, the methods have expanded as real estate uses the capital markets to securitize its assets. In the affordable housing situation, to date, the government, either federal or state, is the only source for bailing out the project. It is ironic, that a program such as the LIHTC, which stimulates the housing supply through the private market, and cannot be utilized without additional subsidies, has yet to establish a "private" method of rescuing its projects from default.

UNIT MIX

Unit mix is a significant issue which is influenced by all three factors. These financing and subsidy complications, in conjunction with the housing market, and the LIHTC program interfere with the desirable housing policy of providing mixed income developments. Due to the way the program is structured the players are often forced to choose between money for the project or "good" housing policy.

With the difficulties in obtaining other subsidies, developers and syndicators encourage 100% LIHTC buildings in order to obtain more capital. This arrangement also benefits investors since they are entitled to a greater tax benefit.

Managing 100% tax credit projects is also less complicated due to the structure of the LIHTC program. When all the units are designated LIHTC, property managers need not concern themselves with the “next available unit” rule and the constant tracking of varying rent schemes. This rule in conjunction with the “vacant v. empty” definitions, can directly affect the health of the project. Managers must choose between lost income or lost credits should an apartment not be rented or rented to the wrong type of tenant. Tenants also profit in 100% LIHTC projects since they are not subject to rent increases should their income surpass the 140% limit. While in some markets, such as Radcliffe, mixed income housing may not be possible due to the socio-economic situation, in those where it is feasible, it is the preferred condition.

The relationship of the LIHTC program, the subsidies and the market is complex and simple solutions are not readily at hand. The inherent characteristics of these three primary factors give rise to a fundamental problem. Two of the factors, the LIHTC program and subsidies, have rigid structures which do not fluctuate with the market. The subsidy programs accommodate only a strong and growing market, not a declining one. Modifications have to take place in the basic structure in order for the LIHTC program to meet the primary objective of supplying affordable housing.

GLOSSARY

CDBG	Community Development Block Grant
CDC	Community Development Corporations
CRA	Community Reinvestment Act
EOCD	Executive Office of Communities and Development
FMR	Fair Market Rent
HFA	Housing Finance Agency
HUD	Department of Housing and Urban Development
IRC	Internal Revenue Code
IRS	Internal Revenue Service
LIHTC	Low Income Housing Tax Credit
MAR	Market Adjusted Rent
MHFA	Massachusetts Housing Finance Agency
MHIC	Massachusetts Housing Investment Corporation
MRVP	Massachusetts Rental Voucher Program
R-DAL	Rental Development Action Loan
SHARP	State Housing Assisted Rental Production
SMSA	Standard Metropolitan Statistical Area
SRO	Single Room Occupancy
TRA 86	Tax Reform Act of 1986

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