Banking and Community
Perspectives

ISSUE 2 2009

FEDERAL RESERVE BANK OF DALLAS

As the LIHTC program faces the biggest challenges of its nearly 25-year history, it's imperative to look holistically at the evolution and distribution patterns of this housing production program.

Low-Income Housing Tax Credits in Texas:

Achievements and Challenges

ISSUE 2 2009

Banking and Community Perspectives

Federal Reserve Bank of Dallas
Community Affairs Office
P.O. Box 655906
Dallas, TX 75265-5906

Gloria Vasquez Brown
Vice President, Public Affairs
gloria.v.brown@dal.frb.org

Alfreda B. Norman
Assistant Vice President and
Community Affairs Officer
alfreda.norman@dal.frb.org

Wenhua Di
Economist
wenhua.di@dal.frb.org

Julie Gunter
Senior Community Affairs Advisor
julie.gunter@dal.frb.org

Jackie Hoyer
Houston Branch
Senior Community Affairs Advisor
jackie.hoyer@dal.frb.org

Roy Lopez
Community Affairs Specialist
roy.lopez@dal.frb.org

Elizabeth Sobel Blum
Community Affairs Research Associate
elizabeth.sobel@dal.frb.org

Editor: Kathy Thacker
Designer: Samantha Coplen
Researchers and Writers: Roy Lopez and Wenhua Di

May 2009

The views expressed are the authors' and should not be attributed to the Federal Reserve Bank of Dallas or the Federal Reserve System. Articles may be reprinted if the source is credited and a copy is provided to the Community Affairs Office.

On the Cover
Low-income housing tax credit project in Austin (center). Photo by Roy Lopez.

This publication and our webzine, *e-Perspectives*, are available on the Dallas Fed website, **www.dallasfed.org**.

Multifamily rental housing is a critical component of our region's changing housing needs. Population growth and economic considerations suggest that multifamily housing will be even more important in Texas moving forward. The low-income housing tax credit (LIHTC) program is the primary vehicle for producing affordable rental housing, but the program is in a period of rapid transition. Repercussions of the economic contraction have spread throughout the community development field, including the LIHTC program. Financial institutions that have been longtime investors in the program are balancing ways to mitigate risk and still meet community development needs.

The LIHTC program has produced 2.5 million units throughout its history. Like most other states, Texas leans heavily on this public–private partnership, which brings the Internal Revenue Service, the state housing agency, investors and developers together in pursuit of solutions for low-income residents seeking quality, affordable housing.

This issue of Banking and Community Perspectives *provides a program overview, a current market-condition analysis and an update on recent regulatory changes. As the LIHTC program faces the biggest challenges of its nearly 25-year history, it's imperative to look holistically at the evolution and distribution patterns of this housing production program.*

Alfreda B. Norman
Assistant Vice President and Community Affairs Officer
Federal Reserve Bank of Dallas

Low-Income Housing Tax Credits in Texas: Achievements and Challenges

For many low-income working families, the search for housing can be frustrating. In Texas, housing advocates point to a lack of decent, affordable rental housing as an obstacle. However, one national program has provided more options for these families for over two decades. The low-income housing tax credit (LIHTC) program produced or preserved 125,000 affordable rental units and infused $9 billion of private investment in 2007 alone, according to the National Council of State Housing Agencies.

Multifamily rental housing is vital to the vibrancy of the economy because it meets the needs of households that do not qualify for or want a mortgage as well as those that have experienced foreclosure. With the nation in recession, the need for affordable rental housing has grown. At the same time, financing for many low-income housing development programs has become more difficult to obtain.

The LIHTC program was born as a part of the Tax Reform Act of 1986. Today, this Ronald Reagan-era initiative has developed into the largest program for producing affordable rental housing. Primarily serving residents making 60 percent of area median income or less, the LIHTC program tenders a dollar-for-dollar federal tax credit to private investors in return for project equity. The equity raised reduces the amount of financing required, allowing rents to be more affordable. The typical amount of tax-credit equity raised in a 9 percent tax-credit transaction is between 45 percent and 75 percent of the development costs.

Investors that have traditionally included financial institutions and corporations purchase tax credits to lower their federal tax liability. Financial institutions receive positive Community Reinvestment Act (CRA) consideration if they purchase credits for a development within their CRA assessment areas.[1] They also earn attractive rates of return. The yields on tax credit investments in recent years have averaged between 5 and 7 percent.[2] In exchange for the investment, the program provides federal tax credits for a 10-year period. Federal law requires that the rents and incomes remain restricted for 15 years, but Texas employs an extended land-use agreement that retains the units in the affordable housing stock for at least 30 years.

The Texas program, administered by the Texas Department of Housing and Community Affairs (TDHCA) with some oversight from the state Legislature, has allocated approximately $750 million in tax credits to developers since its inception. This infusion of equity has contributed to the development or planned development of nearly 200,000 affordable housing units. Competition for the credits has been fierce among developers. TDHCA has 133 active applications seeking a combined $161 million in tax credits in the 2009 allocation cycle. With an estimated $74 million in credits to allocate this year, many projects will not be funded.

Applications are rated on a point system. The stated goal of Texas' LIHTC program is to encourage diversity through the broad geographic allocation of credits, promote maximum use of the available tax credit amount and allocate credits among as many different developments as possible without compromising housing quality.[3]

LIHTC properties can include new construction and the redevelopment of underutilized properties. The program in Texas also requires a minimum 15 percent at-risk development set-aside to allocate to projects that have other subsidies set to expire.

Understanding the distribution of these properties across the state and the current financial challenges can provide insight on the impact and direction of this program.

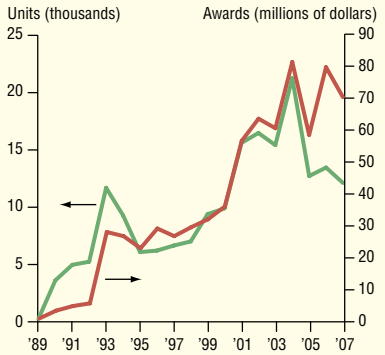
LIHTC Projects in Texas

This study reviews and analyzes TDHCA data on LIHTC projects from 1989 to 2007. The data cover 1,583 projects with a total of 187,646 units. About 95 percent of these units, or 177,908, are reserved for low-income tenants.

Figure 1 shows tax credit allocations cross-tabulated with the number of units created. The red line shows a general increase in allocations to Texas LIHTC properties since 1989. The substantial rise in state allocations by Congress in 2001 and the booming production of bond transactions around the same

Figure 1

LIHTC Units and Program Funding in Texas

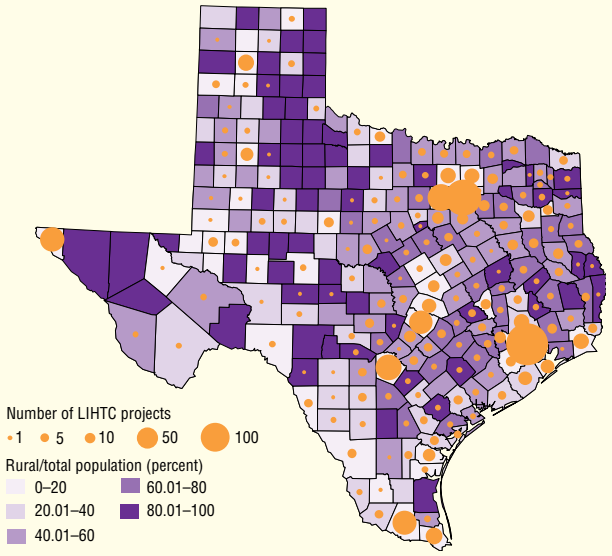


SOURCE: Texas Department of Housing and Community Affairs LIHTC database.

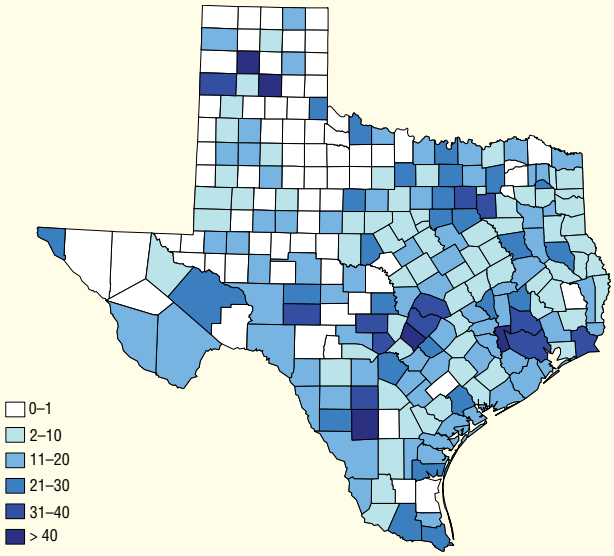
Figure 2

Distribution of LIHTC Developments in Texas Counties

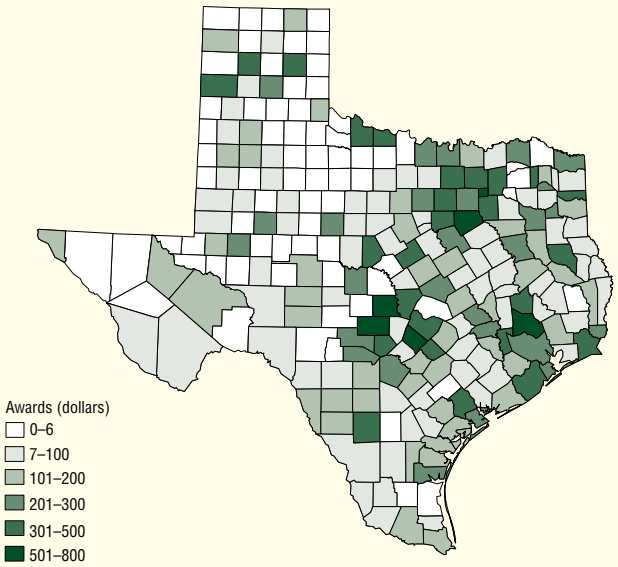
A. Projects and Rural Population



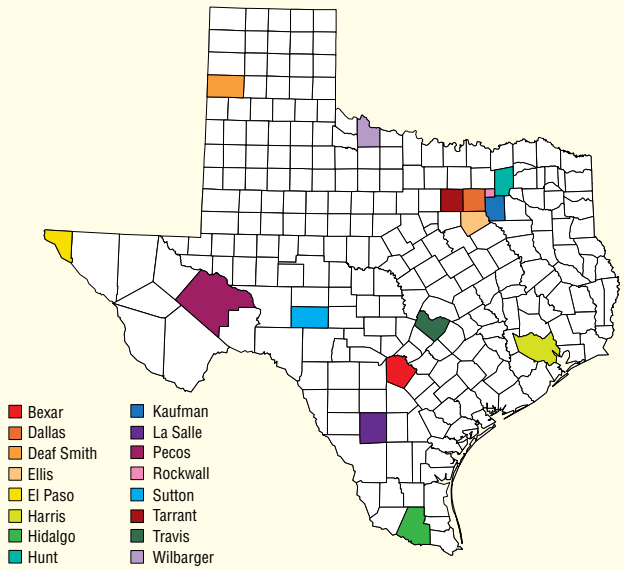
B. LIHTC Units per 1,000 Housing Units



C. LIHTC Awards per Person in Poverty



D. Key to Texas Counties



SOURCES: Texas Department of Housing and Community Affairs LIHTC database, 1989–2007; population and housing data from 2000 census.

time augmented the tax credits awarded.[4] The green line illustrates the number of LIHTC units developed from 1989 to 2007.

LIHTC projects are located in 184 of Texas' 254 counties. Counties without LIHTC projects are generally found in the sparsely populated areas of the Panhandle and West Texas (*Figure 2A*).

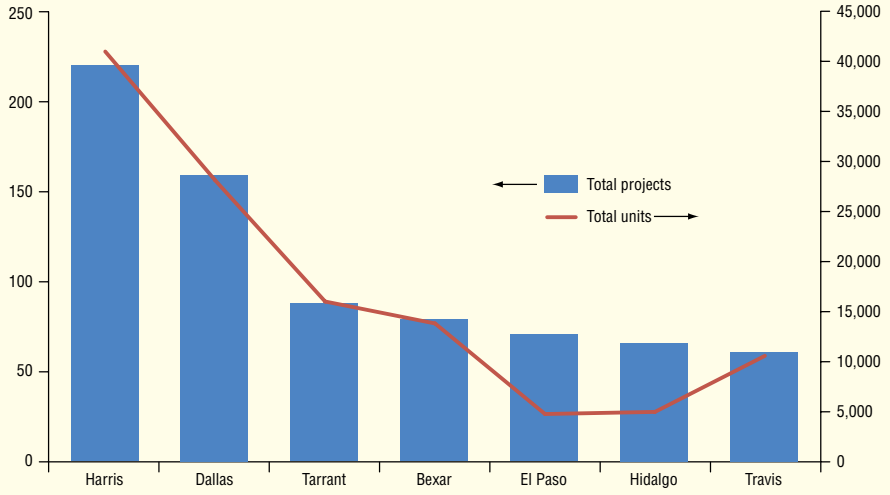
Not surprisingly, counties with the largest populations in Texas have the greatest number of LIHTC properties. Figure 2B details the distribution of LIHTC units per 1,000 housing units. Large metropolitan areas have higher densities of LIHTC units. However, some less-populated, nonmetro counties such as Deaf Smith, Wilbarger, Pecos, Sutton and La Salle have relatively large numbers of LIHTC units, while some densely populated counties such as Bexar (San Antonio) have relatively small numbers of LIHTC units per 1,000 housing units.

To examine the distribution of tax credits by population, Figure 2C displays LIHTC dollars awarded per person in poverty.[5] Large central cities have the most developments in sheer raw numbers but have not received the largest awards if the population in poverty is considered. Counties around central cities generally have received substantially higher LIHTC awards per person in poverty.

For example, Dallas County is the state's

Figure 3

LIHTC Projects and Units Produced from 1989 to 2007



SOURCE: Texas Department of Housing and Community Affairs LIHTC database.

second-largest recipient of LIHTC awards; however, its poor population has not received as many credit allocations as the surrounding counties. Counties near Dallas, such as Tarrant (Fort Worth and Arlington), Ellis, Kaufman, Rockwall and Hunt have received more tax-credit awards. Counties around large metros such as Harris (Houston), Travis (Austin) and Bexar have also received larger amounts of tax credits per person in poverty.

While suburban counties do not necessarily have large low-income populations, they are more likely than the central cities to have raw land available for development. Tax incentives, lower project costs, and demand for workforce housing attract many developers and investors to these undeveloped parcels in suburban counties.

Figure 3 shows the number of LIHTC projects and units in the seven counties with the most LIHTC projects in Texas.

The average size of LIHTC projects is bigger in large metros and smaller in small metros. For example, LIHTC properties average 186 units in Harris County and 181 units in Tarrant County. Parkwoods Apartments (now Tierra Linda) in South Dallas has more than 800 units, and La Casita Apartments in Houston has more than 600 units. Properties in El Paso and Hidalgo average only 66 and 74 units, respectively. Rehabilitation projects tend to be larger in scale.

Large low-income properties often generate concerns about concentrated poverty. A tradeoff can exist between the economy of scale of a LIHTC project and its fulfillment of social integration goals. To address the issue, the state Legislature mandated that LIHTC developments be at least one linear mile from an existing tax credit project or not be in a census tract with a large number of existing affordable units.[6]

Counter to the perception that many public housing projects cluster the nonworking poor, LIHTC properties are typically for working-class families with stable jobs and incomes. Most LIHTC projects are designed for community living and managed by experienced companies. These projects must meet state housing quality standards annually.

Market demand usually determines the location of LIHTC properties. Table 1 shows several census tract characteristics of the seven counties with the largest number of LIHTC projects in Texas.

In all of these counties, more than 90 percent of LIHTC units are reserved for low-income residents. If the project does not maintain rent and income restrictions, the investors will be subject to recapture provisions. Properties, therefore, must maintain detailed records demonstrating the rent and income of each low-income tenant.

The average tract's median income as a share of area median income is approximately 74 percent, with El Paso the highest (97.4 percent) and Dallas the lowest (60.4 percent). Many of these tracts have poverty near or above 20 percent, with Hidalgo the highest (40.7 percent) and Tarrant the lowest (16.4 percent). Although almost all LIHTC tenants are low income, the projects are located in both lower- and higher-income communities. In Dallas, Bexar, El Paso and Hidalgo, LIHTC tenants live in census tracts in which the majority of the population earns less than

Table 1

Characteristics of Census Tracts with LIHTC Projects

County	Total projects	Low-income units (percent)	Average tract median income as share of area median income (percent)	Average tract population in poverty (percent)	Average tract population below 200 percent of poverty (percent)	Average tract minority population (percent)
Harris	221	94.4	73.1	22.4	47.5	71.7
Dallas	160	95.2	60.4	23.2	52.1	74.2
Tarrant	88	94.8	80.8	16.4	38.8	48.2
Bexar	79	92.0	71.1	24.0	55.4	80.9
El Paso	71	99.0	97.4	25.2	55.6	86.3
Hidalgo	66	97.7	90.8	40.7	72.3	93.1
Travis	61	94.7	68.6	19.6	44.9	68.6

NOTE: 2000 census-tract-level data are available for 90 percent of the projects; poverty data are available for 98 percent of projects with census-tract-level data.

SOURCES: Texas Department of Housing and Community Affairs LIHTC database, 1989–2007; 2000 census.

200 percent of poverty. In Harris, Tarrant and Travis, however, LIHTC tenants live in census tracts in which the majority earns more than 200 percent of poverty. LIHTC properties are more likely to be found in neighborhoods with higher proportions of minority residents.

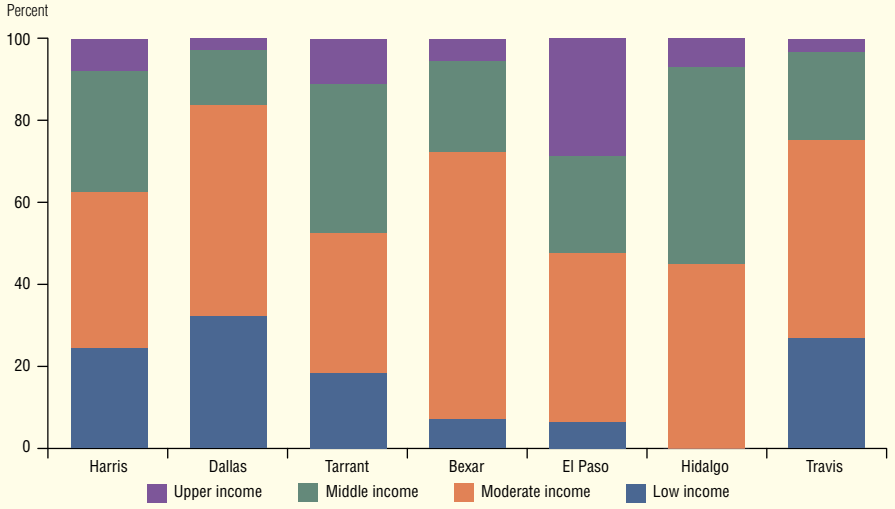
To further examine the integration of LIHTC properties, Figure 4 shows the composition of income levels of census tracts in the seven counties.

Except for El Paso and Hidalgo counties, the majority of LIHTC projects are in low- or moderate-income census tracts. Dallas has more of these projects in low-income census tracts and Bexar has more in moderate-income tracts than the rest of the seven counties. The shares of middle- and upper-income census tracts with LIHTC projects vary substantially. El Paso has more in upper-income tracts and Hidalgo has more in middle-income tracts than the rest of the counties.[7] Tarrant has more LIHTC projects in higher-income tracts than other large metro counties analyzed.[8]

Overall, LIHTC projects in the seven counties examined are in neighborhoods with a variety of income levels and, in some cases, have a significant presence in middle- and upper-income areas. These findings suggest that the Texas LIHTC program may have contributed to deconcentrating poverty and integrating low-income households into higher-income neighborhoods.

Figure 4

Income Levels of Census Tracts with LIHTC Properties



SOURCES: Texas Department of Housing and Community Affairs LIHTC database, 1989–2007; Federal Financial Institutions Examination Council designation of income levels, 2008.

Calculating the Tax Credit

One of the complexities of the tax credit is that actual tax credit rates are not exactly 9 percent and 4 percent annually. Rates also vary on a monthly basis, fluctuating with federal borrowing costs. The tax credit rates are calculated and released monthly by the Treasury Department. Any federal funds used for construction must be subtracted from the eligible basis. This is to avoid a double federal subsidy.

Extra tax credits are given for properties that are located in a qualified census tract (QCT) or a difficult development area (DDA). Developers are eligible to receive a 30 percent qualified-basis boost if they build in these designated areas. The U.S. Department of Housing and Urban Development publishes a list of QCTs and DDAs eligible for basis boost annually.

The table below shows a simplified example of the tax credit calculation for a $5 million project.

Newly constructed apartment building	Amount
Cost (construction and some soft costs)	$5,000,000
Ineligible costs (land acquisition, permanent financing fees, marketing)	–$1,050,000
=	$3,950,000 (eligible basis)
x	100% low income (qualified units)
=	$3,950,000 (qualified basis)
x	8.35% (tax credit rate)
=	$329,825 (per year for 10 years)
x	10 years
=	$3,298,250 (total allocation amount)
x	$0.65 (equity price per credit on open market)
=	$2,143,863 (total project equity)
Debt to finance	$2,856,137

The Economic Slowdown

The LIHTC program has been greatly affected by the financial crisis disrupting projects across the nation. Investor demand has fallen, leaving many properties with capital gaps. Prices for tax credits have dropped dramatically over the past year, meaning developers are raising much less equity than they had expected from their sales. As these gaps have grown, it has become increasingly difficult to float the necessary debt to make the projects a reality. Tax credits were selling at approximately 90 cents on the dollar as recently as 2007. In recent months, prices have dropped below 70 cents on the open market for $1 in tax reduction. Before the downturn, investors could easily raise $9 billion a year nationally in equity; today, that figure is less than $4 billion, leaving projects undercapitalized and unable to close. Even with increased yields, investor demand has waned. This means additional credits are needed to finance some projects, while others wait to be funded. The result is that as many as 1,000 projects containing nearly 150,000 units across the country are currently on hold.

With the financial losses that have been generated by banks and investor corporations in 2008 and 2009, tax credits are no longer needed to offset their federal tax liabilities.

A Case Study: Keller's Aventine Apartments

When Venicia Woods and her two children were looking for rental housing near the Fort Worth Alliance Corridor, she sought market-rate units but knew them to be unaffordable in the area. As a loading dock administrator within the corridor, her pay was well below the area median income. To her surprise, she found a home in the corridor that was safe and filled with quality amenities. She found Aventine Apartments in Keller, a 4 percent tax-credit property by longtime developer Granger McDonald of Kerrville, Texas.

"The biggest selling point was its affordability," Woods said. Rents were 30 to 50 percent below comparable housing found within this expanding pocket of northern Tarrant County. A one-bedroom, 800-square-foot unit rents for $657.

Because the property is subsidized with tax credits, the built-in equity available through the tax credit program allows rents to be below market rate. With an income of less than 60 percent of area median income, Woods qualified to live at Aventine. Even if she were to exceed the 60 percent threshold, Woods would not be required to relocate unless her income increased dramatically.

Her neighbors include local schoolteachers, police officers and firefighters and employees of the burgeoning service industry within the Alliance Corridor.

"In an economic down market, we find ourselves near full occupancy. We have even taken in residents with foreclosures," said Melissa Johnson, assistant manager at Aventine. The tax credit program allows property managers to screen tenants for past criminal activity and can obligate prospective tenants to prove they have twice the amount of one month's rent at the beginning of their leases. Proof of employment is a requirement.

Aventine's amenities include a swimming pool, two children's playgrounds, a media room and a host of social services such as fitness, financial education and computer classes for adults and children.

Aventine is located in the Keller Independent School District, which was rated "recognized" by the Texas Education Agency in 2008. "The children of Aventine who attend public school in Keller contribute to greater socioeconomic diversity," said McDonald, the developer.

Developments like Aventine have been difficult to build in many upper-middle-class neighborhoods in Texas because of organized opposition to any affordable-housing development.

With a median household income of over $109,000, Keller has a 93 percent homeownership rate and a median home price of over $281,000. In 2007, Keller was among the top 50 best places to live, according to CNNMoney.com.

"I came to Aventine because the price was right, the school quality, and the availability and diversity of jobs. It changed my life for the better," said Woods, who used to reside in inner-city Fort Worth.

Adding to the price drop, the two largest buyers of tax credits are out of the market. Fannie Mae and Freddie Mac, now under government conservatorship, bought roughly 40 percent of all tax credits in 2006 and 2007. This has left a huge gap that other equity providers have yet to fill. Fueling the turmoil, a 4 percent tax credit, automatic with the use of tax-exempt private-activity bonds, has been virtually eliminated as a tool because of market conditions.

This economic climate has affected most LIHTC development budgets and, consequently, limited affordable housing starts. Both developers and housing finance experts report that projects are having trouble raising money as investors have fled the market.[9] "Now the primary motivator behind the tax credit is the CRA," mentioned K. Nicole Flores with PNC MultiFamily Capital.

In October, Congress tried to address the problem with the Housing and Economic Recovery Act of 2008, which increased the credit allocation for LIHTCs by 10 percent for 2008 and 2009 to $2.20 per state resident. Despite the volume increase, developers are still having difficulty closing deals across the country. San Antonio-based developer Dan Markson noted in March, "Of those that received a 2008 Texas allocation, only two deals have closed."

Urban tax-credit projects are finding relatively more success than their rural counterparts. Traditional CRA-motivated investors from mostly large financial institutions tend to focus on LIHTC activity in urban markets because examiners focus on larger assessment areas. If seeking CRA credit, banks will primarily invest in locations in which the majority of their loans and deposits are made. Some local investors argue that this practice has led to LIHTC gaps in rural markets, since smaller community banks are unfamiliar with or not expected to undertake CRA investments.[10]

"These geographic restrictions—where banks are not receiving credit—need to be a part of a comprehensive CRA reform package," said developer Steve Ford with Resolution Inc.

Markson said CRA is one issue; another is banks' application of the government's Troubled Asset Relief Program (TARP).[11] "Our hope was that banks would use some of the TARP money to stabilize their balance sheets and free up some of the constraints found in the capital markets," he said in March. "However, what we hear is banks hoarding cash to cushion against unforeseen losses."

Advocates and developers both cite increased demand for affordable rental housing due to job declines, more stringent underwriting standards for single-family home purchases and the foreclosure crisis that has hit many communities. Developers often mention the positive economic impact of building quality affordable housing. In 2007, the National Association of Home Builders estimated the one-year local impact of a 100-unit tax credit development to be $7.3 million in income, 151 jobs created and $783,000 in taxes and other revenue for local governments.[12]

Investors in the tax credit market have been floating proposals to make the program more attractive to fellow investors. Ideas include reducing the tax credit reimbursement period from 10 to five years; increasing outreach to sell LIHTCs to individuals, smaller financial institutions, and corporations such as large oil companies that could benefit from the program; and changing federal rules to serve households earning up to 80 percent of area median income instead of 60 percent.

"If we want to increase our investor pool, the key would be to create a five-year carryback

Federal Reserve Bank of Dallas
P.O. Box 655906
Dallas, TX 75265-5906

PRSRT STD
U.S. POSTAGE
PAID
DALLAS, TEXAS
PERMIT NO. 151

period. It is impossible to predict tax liability over a 10-year period," said Patrick Nash, managing director of J.P. Morgan Capital Corp. and president of the Affordable Housing Investors Council.

Developers continue to be cautious about the future in Texas. They are looking to government subsidies and rescue programs and taking unprecedented steps by returning tax credits to the TDHCA—which can now be done without penalty. Developers trying to enter the tax credit market are being stymied as investors choose to work with only the most experienced development teams.

TDHCA has been exploring options available to the state under the American Recovery and Reinvestment Act of 2009, the stimulus bill. TDHCA's board plans to address the undercapitalization with two programs, the Tax Credit Exchange Program and the Home Investment Partnership Program, commonly referred to as the Tax Credit Assistance Program (TCAP). The programs attempt to keep the supply of multifamily affordable housing flowing.

The exchange program would permit TDHCA to swap annual state credit ceilings for cash with the Treasury Department at 85 cents on the dollar and then offer those funds to developers to supplement or replace tax credits or other sources in the financing structure. If credits are exchanged, TDHCA would be assured a significant portion of a development's funding is made in cash, rather than in credits that would have to be sold in an unstable market. The program would be available to 40 percent of the 2009 allocation and 100 percent of the 2007 and 2008 allocations that are unsold.

TCAP provides grant funding for capital investment in projects via a formula-based allocation to state housing credit-allocation agencies. Under the stimulus bill, $148.3 million in additional funds will come to TDHCA. These funds may be used only for 2007, 2008 and new 2009 tax-credit developments that have a financial gap.

Developers, investors and the state housing agency are waiting for guidance from the Treasury Department and Department of Housing and Urban Development on both of these programs. "This is a radically new way of doing business; the stimulus funds are going to require new layers of documentation and oversight. Patience will be required by all," said Linda McMahon, who leads J.P. Morgan Chase's community development efforts in the Southwest.

Nash explained that he was supportive of these programs but added that "they do little to ensure the long-term viability of getting investors back into the market—this is a temporary, stop-gap measure."

Markson said, "This buys us time while markets stabilize."

LIHTC: A Collaborative Effort

The LIHTC is a program rooted in partnership. Investors and syndicators stress the need to expand the capital base, while pointing to the safety and soundness of LIHTC investments, their historically attractive rates of return and the potential CRA benefits. Developers cite the need for more capital and tout the job creation and economic stimulus provided by such projects. Government agencies and elected officials try to fill the gaps, using sustainable underwriting standards, adding incentives to jump-start production and coping with increased regulatory pressures. All hope to reinvigorate communities hurt by the recession and supply citizens with quality affordable housing.

Notes

[1] For more information, see www.ffiec.gov/cra/default.htm.

[2] See "Low-Income Housing Tax Credits: Affordable Housing Investment Opportunities for Banks," *Community Developments Insights*, Office of the Comptroller of the Currency, February 2008.

[3] For more information, see www.tdhca.state.tx.us/multifamily/htc/docs/08-QAP.pdf.

[4] Allocations were $1.25 per capita in 1986–2000, $1.50 in 2001, $1.75 in 2002–03, $1.80 in 2004 and $1.85 in 2005. They were indexed for inflation annually beginning in 2004.

[5] Poverty data are from the 2000 census. The poverty threshold for a family of four, including two children under 18, was $17,463.

[6] For more information, see section 50.6 in www.tdhca.state.tx.us/multifamily/htc/docs/08-QAP.pdf.

[7] Lower-income areas in Hidalgo and El Paso counties often lack the infrastructure for large multifamily developments.

[8] Tarrant County has less of its population in poverty than Dallas County; however, Tarrant may have more scattered pockets of poverty and qualify for extra incentives to develop LIHTC projects.

[9] From interviews with a select group of LIHTC developers.

[10] "Recap Update: Rethinking and Re-engineering the LIHTC Value Chain," by David A. Smith and Ethan Handelman, Recap Advisors, April 15, 2009.

[11] For more information, see www.financialstability.gov/about/oversight.html.

[12] For more information, see "The Local Economic Impact of a Typical Tax Credit Housing Project," National Association of Home Builders, September 2007, www.nahb.org/fileUpload_details.aspx?contentTypeID=3&contentID=35601&subContentID=119693.