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PUBLIC HOUSING

Low-Income Housing Tax Credit as an Alternative Development Method

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Resources, Community, and
Economic Development Division

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The Honorable Paul S. Sarbanes
Chairman
The Honorable Christopher S. Bond
Ranking Minority Member
Subcommittee on Housing and Urban Affairs
Committee on Banking, Housing, and Urban Affairs
United States Senate

The Honorable Henry B. Gonzalez
Chairman
The Honorable Marge Roukema
Ranking Minority Member
Subcommittee on Housing and Community Development
Committee on Banking, Finance and Urban Affairs
House of Representatives

Section 526 of the National Affordable Housing Act of 1990 (P.L. 101-625) directed GAO to review different methods of developing publicly controlled housing units. This mandate resulted from congressional deliberations about the degree to which other federal programs, primarily the Low-Income Housing Tax Credit Program, might achieve outcomes similar to those of the Public Housing Development Program. These two programs are designed to develop housing for low-income households, either through the acquisition of previously constructed units or construction of new units. The Public Housing Development Program provides direct grants from the Department of Housing and Urban Development (HUD) to public housing authorities (PHA). Under the Low-Income Housing Tax Credit Program, which has been the primary alternative to direct public funding since its enactment in 1986,[1] selected PHAs may raise funds for development by forming public-private partnerships with investors.

As subsequently agreed with your offices, we compared PHAs' development of housing under the Public Housing Development Program and the Low-Income Housing Tax Credit Program. In comparing the two programs, our specific objectives were to (1) provide information on the

[1]This program, enacted in the Tax Reform Act of 1986, expired in June 1992 but may be reauthorized in 1993.

characteristics of the tenants served, including household size, the kind of household (whether it includes elderly tenants or children), and income level; (2) provide information on the characteristics of the projects developed, including whether projects were on single or multiple sites, what types of neighborhoods the projects were located in, and what types of units were developed; (3) analyze the costs of each program to the federal government; and (4) describe the administrative experiences of PHAS when developing housing through each program.

Nationally, only nine PHAS completed projects under both programs between 1989 and 1991. To address our first and second objectives, we collected data on one project financed with tax credits and one project financed through a public housing grant at each of these nine PHAS. To address our third objective, we conducted a detailed cost analysis comparing the tax credit project and the public housing project at one of these PHAS. To address our fourth objective, we visited four of the PHAS to collect detailed information on their administrative experiences when developing housing through each program. We limited our review to PHAS that had developed housing through both programs to compare projects developed under similar local conditions. Although we included all of the PHAS we could identify—nine—that had used both programs in 1989, 1990, or 1991, our findings about these projects cannot be generalized to all tax credit or all public housing projects. For more detailed information on our scope and methodology, see appendix I.

Results in Brief

Most of the nine PHAS we reviewed used their tax credit projects to serve smaller households, which were more often elderly, than those served in the public housing projects. Furthermore, the Low-Income Housing Tax Credit Program by itself could not serve households with incomes as low as those served by the Public Housing Development Program. Because the tax credit program provides funds for development, not operating costs, households with lower incomes could not pay enough rent to cover a project's operating costs. However, the combination of tax credits and other federal subsidies, such as Section 8 rental assistance, enabled tax credit projects to serve households with incomes as low as those in public housing.

Regarding the physical characteristics of the projects, we found differences in the location of projects and the type of housing developed through the tax credit and public housing programs. In the early 1970s, HUD placed restrictions on the location and type of additional public housing units that could be developed to encourage the scattering of low-income and minority households. The tax credit program, however, contains no similar restrictions. Accordingly, seven of the nine tax credit projects we reviewed were developed on one site, while seven of the nine public housing projects were developed on multiple sites. In addition, more tax credit projects than public housing projects were developed in predominantly low-income neighborhoods, and more were located in predominantly minority neighborhoods. Finally, under the tax credit program, PHAS developed a greater variety of unit types, ranging from town homes to manufactured homes.

According to our detailed cost analysis at one PHA, for about the same level of federal expenditure, the public housing project served households with much lower incomes than those served by the tax credit project. Moreover, federal expenditures for the tax credit project would have to increase substantially to serve households with incomes as low as those in the public housing project. (App. IV presents our analysis in detail.) A number of factors contributed to the relative costliness of this tax credit project, such as the administrative fees paid to lawyers and other consultants, that were not required for public housing development. The other three PHAS we visited also told us that they experienced higher administrative costs when using the tax credit program than when using the public housing program.

Developing housing through each of the programs required PHAS to overcome administrative obstacles. For the four PHAS we visited, the greatest obstacle with the public housing program was the multitude of HUD regulations and procedures that govern the development of public housing. With the tax credit program, the greatest obstacle was finding other funding sources, such as commercial loans and state subsidies, to cover development costs. However, with relatively few funds available through the Public Housing Development Program, PHAS said the Low-Income Tax Credit Program is a valuable tool for developing additional publicly controlled housing for low-income people.

Background

As the principal federal agency for housing programs, HUD assists about 4.4 million low-income households. As of 1991, about 1.4 million of these households lived in public housing units—units owned, developed, operated, and maintained by PHAS with financial support from HUD. Managing the public housing stock is the primary mission of the 3,400 PHAS located across the country.

Through the public housing program, HUD provides selected PHAS with grants and oversees the PHAS' activities in developing additional housing units. According to HUD, 184 PHAS completed public housing projects between 1989 and 1991. HUD provides PHAS with an operating subsidy to make up the difference between the rental income the PHA collects from tenants and the expense of operating the project. Only tenants with incomes less than 50 percent of the median income in an area are eligible to live in newly developed public housing. Appendix II contains additional information on the public housing program.

The number of housing units completed annually by PHAS through the public housing program has decreased from 29,576 in 1981 to 2,603 in 1991 because of declining federal funding. During the same period, some low-income households, particularly large families, continued to face serious housing deficiencies, according to studies by HUD and Harvard University.[2] The decrease in federal funding for public housing development, coupled with persistent housing needs among some low-income families, has prompted increased innovation among some PHAS in using alternative funding sources to develop low-income housing, such as the Low-Income Housing Tax Credit Program.

The tax credit program is administered by the Department of the Treasury and by state tax credit allocation agencies. The state agencies determine which housing projects should receive allocations of tax credits and, following federally prescribed guidelines, how much each should receive. The program is used primarily by private for-profit and nonprofit housing developers, although a few PHAS have also used it. According to the National Association of Housing and Redevelopment Officials, less than 4 percent of the PHAS that responded to its 1991 survey had participated in the Low-Income Housing Tax Credit Program during 1989 and 1990.[3]

Developers with no tax liabilities, including PHAS and nonprofit organizations, convert their tax credit allocations into development funding by forming partnerships with corporations or other private investors. Many developers contract with outside firms called syndicators to find these investors. An investor provides a developer with cash it can use for developing the housing and receives in return an income tax credit for 10 years. During this period, the project is owned by the partnership,

[2]Priority Housing Problems and "Worst Case" Needs in 1989, HUD (June 1991) and The State of the Nation's Housing, 1991, Joint Center for Housing Studies of Harvard University (Cambridge, Mass: 1991).

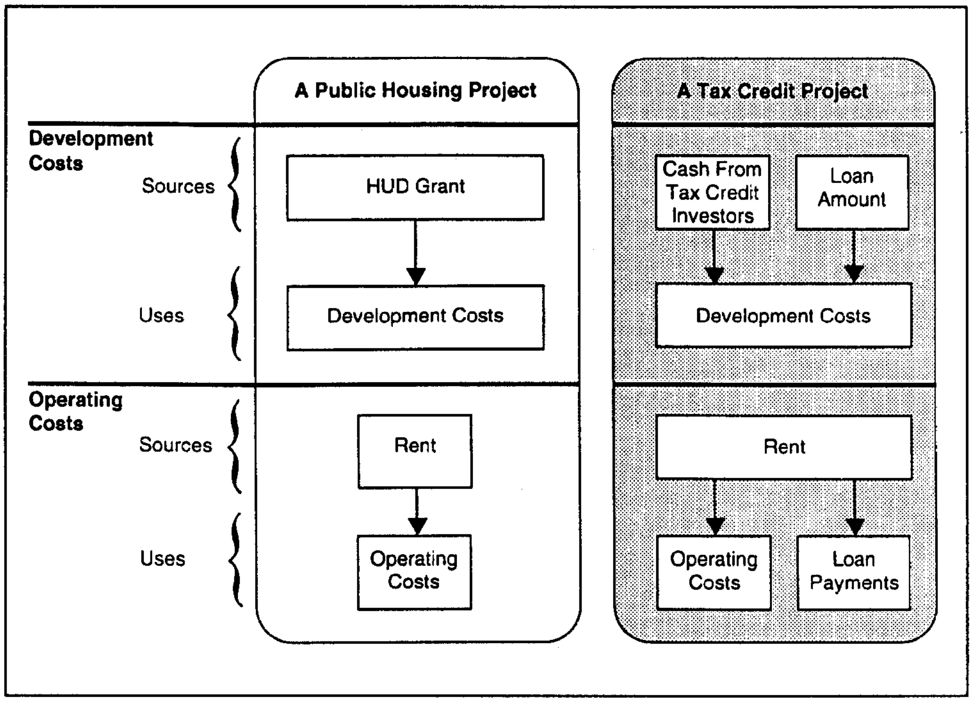
[3]All PHAs in the country were surveyed; the response rate was approximately 50 percent.

with most shares held by the investor. As a partner, the investor also shares in any losses or profits the project has during the 10-year tax credit term. Therefore, the investor may also receive tax benefits if the project incurs tax-deductible operating losses. The tax credit program provides no operating subsidies for any shortfall between a project's operating expenses and tenant rents. Only tenants with incomes of less than 60 percent of an area's median income are eligible to live in housing developed with the tax credit.[4] Appendix II contains additional information on the tax credit program.

Because tax credits are not intended to provide developers with the full amount of cash they need to develop housing, developers often take out commercial loans to supplement their tax credits. In contrast, the grant provided through the public housing program covers virtually all of the costs of developing housing. As shown in figure 1, the additional loans often needed to develop housing with the tax credits require that tax credit projects produce more rent than public housing projects with equivalent development and operating costs. While the rents from a public housing project are devoted exclusively to its operating costs, a tax credit project's rents must cover both the costs of operating the project and repayment of the loan taken out for development costs.

[4]Throughout this report, the term "tax credit project" refers only to units developed for tenants with incomes below this limit.

Figure 1: Sources and Uses of Funds for Equivalent Public Housing and Tax Credit Projects



The Tax Credit and Public Housing Programs Serve Different Types of Low-Income Households

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

Tax Credit Projects Serve More Elderly, but Fewer Large Families

Before 1990, PHAs were encouraged to develop public housing for households with children and discouraged from developing public housing for the elderly by the Housing and Urban-Rural Recovery Act of 1983, according to a HUD official. As a result, very little public housing for the elderly was developed between 1983 and 1990, the official explained. Although the National Affordable Housing Act of 1990 enabled more PHAs to develop public housing for the elderly, HUD continued to encourage them to develop large public housing units because of the substantial unmet housing needs reported among large low-income families.[5] As a

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

result of its study of housing problems and needs in 1989, HUD found that families with children were somewhat more likely to have serious housing problems than were the elderly. However, the regulations governing the tax credit program do not encourage or discourage the development of larger units or units for the elderly.

At the nine PHAs we reviewed, seven tax credit projects but only three public housing projects served some elderly households.[6] Of the 333 units in the nine public housing projects, 98 percent were occupied by households with children and only 2 percent by elderly households. Conversely, of the 543 units in the nine tax credit projects, more than 40 percent were occupied by elderly households and fewer than 60 percent by households with children.

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

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

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

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

[6]To gather information on the types of households served by the two programs, we asked PHAs how many elderly households lived in each project. We did not provide them with a definition of the term "elderly."

The Two Programs Produce Some Differences in Other Housing Characteristics

Unlike the development of public housing projects, the development of tax credit projects is not subject to HUD regulation and review. Therefore, the PHAS we reviewed often chose different types of sites, neighborhoods, and units when they used tax credits.

Tax Credit Projects Were More Often on Single Sites

After observing the problems of concentrating households with children on single sites, HUD began to encourage PHAS to develop public housing for these types of families on scattered sites in the early 1970s.[7] PHAS that plan to develop scattered-site public housing units receive extra points when HUD reviews their applications for funding. No such incentive exists for the tax credit program. Without this incentive, developers may prefer single-site projects if their development and operating costs are lower than for scattered-site projects.

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

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

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

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

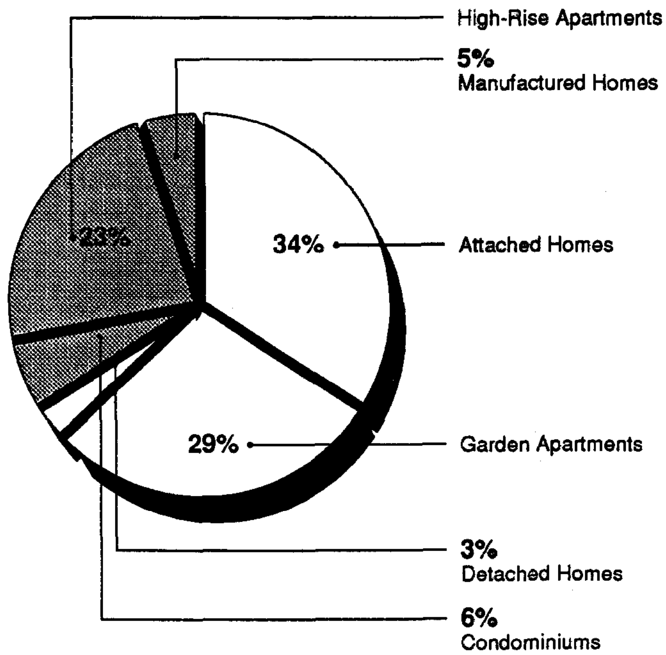
[7] A project with units located in several different neighborhoods may be considered a scattered-site project. However, we did not provide PHAs with a definition of the this term when we asked them whether projects were scattered-site projects.

Greater Variety of Units Was Developed Under the Tax Credit Program

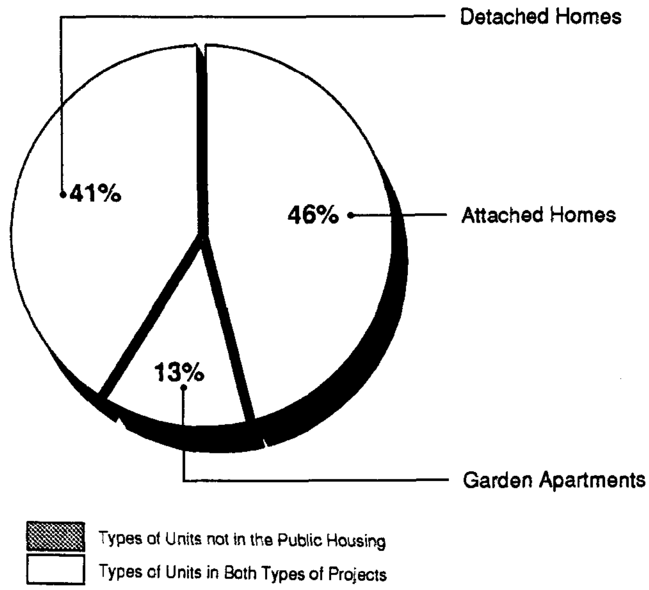
A greater variety of types of units was developed through the tax credit program than through the public housing program. As shown in figure 2, more "attached homes"—town homes, duplexes, triplexes, and quadplexes—were developed through both programs than any other type of unit. However, more than one-quarter of the tax credit units were of types not found in the public housing projects—apartments in condominium and high-rise buildings and manufactured homes. HUD discourages PHAs from developing these types of units through the public housing program, primarily because of density and durability concerns. But the tax credit program does not restrict developers' choices about unit types.

Figure 2: Types of Units Developed Through the Tax Credit and Public Housing Programs at Nine PHAs

Tax Credit Units



Public Housing Units



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

Costs to the Federal Government for the Two Housing Development Programs Differ

Grants from HUD covered virtually all of the costs of developing the public housing projects we reviewed, while tax credits only generated enough cash to pay for a little more than half of the costs of developing the tax credit projects, according to the PHAs we reviewed that had comparable development cost data available. However, our analysis at the Housing Opportunities Commission of Montgomery County, Maryland, (HOC) indicated that it costs the federal government more to use tax credits, rather than public housing, to serve households as poor as those in the PHA's public housing project.[8]

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

The federal government covered less than 60 percent of the costs of developing the tax credit projects but virtually all of the costs of developing the public housing projects at the PHAs we reviewed.[9] For example, at the Housing Authority of the County of Monterey (California), the cost of developing one public housing project was $4,206,798. Approximately 98 percent of that cost, or $4,119,925, was provided by HUD through a public housing development grant. The cost of developing the PHA's smaller tax credit project was $2,171,000. However, only 44 percent of that cost, or $948,000, was covered through the tax credit program by the cash contribution from the tax credit investors. To cover the remaining costs of developing tax credit projects, seven of the nine PHAs we reviewed had to obtain conventional loans or other subsidies.

Case Study Illustrates Higher Long-Term Costs to the Federal Government of the Tax Credit Program

In our case study at the HOC, we determined that, for about the same level of federal expenditure per unit, much poorer households are served by the public housing project than by the tax credit project. According to our estimates, the cost to the federal government of serving these very poor households in the tax credit project would be substantially higher.[10]

According to our estimates, developing and operating the public housing and tax credit projects could cost the federal government similar amounts

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

[9]For the tax credit projects, comparable development cost data were available at seven of the nine PHAs we reviewed. For the public housing projects, comparable development cost data were available at eight of the PHAs.

[10]We used the HOC for our case study because the units for both the public housing and tax credit projects were comparable in several respects. The units for both projects were mostly town homes of equal value scattered throughout market-rate housing developments. The HOC paid about the same purchase price for all of the units.

during their first 15 years, under certain assumptions—$72,000 and $67,000 per unit, respectively.[11] (See app. IV.) However, the public housing project serves households with incomes lower than those in the tax credit project. In 1992, households in the public housing project paid an average monthly rent of $187; households in the tax credit project paid an average monthly rent of $437.

If the HOC wanted to use the tax credit project to serve tenants as poor as its public housing tenants, it would need additional federal funds, such as rental subsidies from the Section 8 program, to cover its operating and debt service costs.[12] We estimated that combining Section 8 funds with the tax credit could cause federal expenditures to increase to as much as $91,000 per unit during the project's first 15 years, well beyond the costs of serving these tenants in the public housing project—$72,000.

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

The tax credit program, in the HOC case, is a more expensive way for the federal government to serve households as poor as those in public housing, primarily because (1) higher administrative fees, paid by the PHA and reimbursed by the federal government, were required when using the tax credit than when developing public housing and (2) the federal government pays a rate of return that is higher than the Treasury borrowing rate to obtain funds from the tax credit investor.[13]

First, the HOC's tax credit project is more costly per unit to the federal government than public housing because of the additional administrative fees the HOC incurred when using the tax credit. Although the HOC paid about the same amounts to purchase the units in both projects, the additional administrative fees it incurred to develop the tax credit project substantially raised the project's total development costs. According to HOC officials, developing tax credit housing entails much higher administrative costs than public housing because of the administrative demands of using the tax credit, such as hiring lawyers.

Like the HOC, the three other PHAS we visited believed they used an unusually large portion of the cash provided by the tax credit for

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

[12]The Section 8 existing certificate or housing voucher programs provide rental subsidies for low-income households.

[13]The Treasury borrowing rate is the rate at which the federal government borrows money, by selling Treasury bonds, to make direct expenditures, such as the public housing development grant.

administrative costs. Although both the tax credit and public housing programs have some common administrative costs, tax credit projects may require payment of syndicator, legal, and accountant fees that are not typically required when PHAs develop public housing. For example, the three other PHAs we visited used from 2 to 10 percent of the cash raised from investors to pay fees to syndicators. Furthermore, a HUD study of 104 tax credit projects found that average syndication costs consumed from 13.8 to 22.9 percent of the funds raised from the tax credits.[14]

Second, the federal government is paying a higher rate of return to obtain funds from tax credit investors than it pays on long-term Treasury securities.[15] However, there is uncertainty in estimating how much higher the rate is because the rate depends on future tax benefits. For the HOC case, we made a series of assumptions and estimated that on a per-unit basis the value of the investor's projected tax benefits during the project's first 15 years could be $67,000, which substantially exceeds the investor's up-front cash contribution of about $52,000.[16] The $15,000 difference, calculated under our assumptions, reflects an estimated annual rate of return to the tax credit investor of approximately 17 percent—a rate substantially higher than the rate of 8.55 percent provided in 1990 on 10-year Treasury securities.

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

[14] Evaluation of the Low-Income Housing Tax Credit: Final Report (Feb. 1991).

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

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

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

among investors for the opportunity to participate in the tax credit program.[18]

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

PHAs Had to Overcome Administrative Obstacles to Use Each of the Programs

The four PHAS we visited had to overcome administrative obstacles to use each program. These obstacles were somewhat offset in the tax credit program by the quicker development of projects.

According to officials at the four PHAS, a variety of federal regulations and procedures for the public housing program greatly affected the way these projects were developed and sometimes slowed their completion.[21] Burdensome processing issues cited by the PHAS included HUD's site-selection criteria, appraisal requirements, and limits on the costs the PHA could incur when developing each unit. The PHAS also experienced delays when obtaining approvals from HUD staff on the many documents HUD requires PHAS to submit when developing public housing. Despite these administrative burdens, officials at three of the four PHAS stated that the public housing program—which has been in existence much longer than the tax credit program—was generally easier to use.

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

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

[20]Michael A. Stegman, "The Excessive Costs of Creative Finance," Housing Policy Debate, Vol. 2, Issue 2 (1991). The government's opportunity cost is often equated with the Treasury borrowing rate.

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

Two of the PHAS developed housing much more quickly with the tax credit program than the public housing program.[22] The development time—from the date the PHAS initially submitted an application to HUD or their state tax credit allocation agency for funds to the date tenants occupied the units—was 1-1/2 to 3 years shorter for the tax credit projects than for the public housing projects.

The four PHAS reported facing a number of unique financial and administrative requirements when developing their tax credit projects. These PHAS experienced difficulties in securing investors for the tax credits and in obtaining the additional funding needed to cover project costs. Regardless of these difficulties, officials at several of the PHAS planned to use the tax credit program again, stating that it is one of the only remaining ways they can raise funds to develop housing. (See app. V for more discussion of the PHAS' administrative experiences.)

Conclusions

The PHAS we reviewed used the tax credit program to serve different types of tenants and to develop different types of projects from those in the public housing program. For example, the tax credit projects we reviewed served smaller households and were more likely to be located in predominantly low-income neighborhoods than were the public housing projects. Furthermore, if the cost inefficiencies suggested by our case study at the HOC occur with other tax credit projects, the tax credit program may be a more expensive way than the public housing program for the federal government to serve very low-income households. Nevertheless, the PHAS we reviewed found the tax credit program a valuable resource in this period of declining federal funds for developing public housing.

Agency Comments

We received written comments on a draft of this report from three HUD offices: the Office of the Assistant Secretary for Public and Indian Housing, the Office of the Assistant Secretary for Policy Development and Research, and the Office of the Assistant Secretary for Administration (see app. VI). In response to these comments, we added information on a HUD study of the tax credit program, expanded our discussion of the

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

administrative obstacles experienced by PHAS, and corrected a statement about HUD's review of tax credit projects.

Most of the comments provided by these three offices pertained to expanding the scope of our study. We limited our scope to the nine PHAS that had recently developed housing through both the public housing and tax credit programs to ensure that the projects we compared had been developed under similar local conditions. We looked only at housing developed by PHAS because the legislative mandate for our study required that we evaluate methods of developing publicly controlled housing. PHAS are responsible primarily for managing publicly controlled housing.

The Office of the Assistant Secretary for Public and Indian Housing stated that our study was conducted in an objective manner and that it raised a number of issues that deserve continuing analysis, such as the social impacts that housing developed on a large scale with the tax credit program has on communities. In contrast, the Office of the Assistant Secretary for Administration stated that the report seemed to favor the public housing program. However, this office assumed that tax credits must be used in conjunction with Section 8 subsidies, though five of the nine PHAS we reviewed did not receive any federal operating funds, such as Section 8 subsidies, for their tax credit projects. The Office of Policy Development and Research suggested that we include information from a HUD study of the tax credit program. We revised the report to include this information.

We obtained information for this report from PHA and HUD officials and several housing experts from academia and nonprofit organizations. A more detailed description of our objectives, scope, and methodology appears in appendix I. We conducted our review between July 1991 and February 1993 in accordance with generally accepted government auditing standards.

We are sending copies of this report to the Secretaries of HUD and the Treasury. We will also make copies available to others on request.

Please contact me at (202) 512-7631 if you or your staff have any questions. Major contributors to this report are listed in appendix VII.

Judy England-Joseph

Judy England-Joseph
Director, Housing and Community
Development Issues

Contents

Abbreviations

HUD	U.S. Department of Housing and Urban Development
PHA	Public Housing Authority
HOC	The Housing Opportunities Commission of Montgomery County, Maryland

Objectives, Scope, and Methodology

Section 526 of the National Affordable Housing Act of 1990 (P.L. 101-625) directed GAO to review alternative methods of developing publicly controlled housing units, other than under the existing Public Housing Development Program. In response to this mandate, we agreed to compare public housing authorities' (PHA) provision of housing under the Public Housing Development Program and the Low-Income Housing Tax Credit Program. Specifically, we agreed to provide information on the two programs in the following areas: (1) characteristics of the tenants served, (2) characteristics of the projects developed, (3) costs to the federal government, and (4) administrative experiences of PHAS when developing housing through each program.

To address our objectives, we collected information at selected PHAS; reviewed Department of Housing and Urban Development (HUD) records and reports; and interviewed HUD officials as well as housing experts from academia, from nonprofit organizations, and from government agencies. We limited our review to PHAS that had completed development of housing through both the tax credit and public housing programs in 1989, 1990, or 1991. Nationwide, only nine PHAS met these conditions, according to records supplied by the National Association of Housing and Redevelopment Officials and HUD.[1] The nine PHAS we reviewed were the (1) Housing Opportunities Commission of Montgomery County, Maryland (the HOC); (2) Alexandria Redevelopment and Housing Authority, Virginia; (3) Sacramento Housing and Redevelopment Agency, California; (4) Housing Authority of the County of Monterey, California; (5) Housing Authority of Tulare County, California; (6) Grand Rapids Housing Commission, Michigan; (7) Housing Authority of the County of Clackamas, Oregon; (8) Macon Housing Authority, Georgia; and (9) Housing Authority of the City of Prichard, Alabama.

We reviewed only projects developed by PHAS because they are primarily responsible for managing publicly controlled housing. We limited our review to PHAS that had developed both types of housing to ensure that the projects we compared had been developed under similar local conditions, such as zoning rules and housing prices. We did not review a sample of PHAS that is representative of all PHAS that used the tax credit or of all PHAS

[1]We identified PHAs that had recently used the public housing program by using lists supplied by HUD of PHAs that had completed developing projects during 1989, 1990, and 1991. We identified PHAs that had recently used the tax credit program by using the results of a survey conducted by the National Association of Housing and Redevelopment Officials. Sent to all of the approximately 3,400 PHAs in the country, the survey asked PHAs to indicate whether they had participated in the tax credit program in 1989 or 1990. The survey's response rate was approximately 50 percent.

that used the public housing development program. For this reason, our findings are not generalizable to all tax credit or public housing projects.

For the tax credit and public housing projects most recently completed by each of the nine PHAs by January 1992 (18 projects), we collected information on the tenants served by the projects and other characteristics of the projects. We also visited four of these PHAs to collect detailed information on their experiences during the development process for their two projects. We visited PHAs in the following four areas: (1) Montgomery County, Maryland; (2) Alexandria, Virginia; (3) Sacramento, California; and (4) Monterey County, California. We collected information at the PHAs by reviewing PHA records, interviewing PHA officials, and visiting public housing and tax credit projects.

We conducted a case study of the two projects developed at the Housing Opportunities Commission of Montgomery County, Maryland, to determine their costs to the federal government over a 15-year period. The case study analysis is based on this PHA's estimates of costs incurred and subsidies received to develop and operate the two projects.

HUD provided written comments on a draft of this report. These comments are reprinted in appendix VI.

The Public Housing and Low-Income Housing Tax Credit Programs

This appendix describes the operations of the public housing and low-income housing tax credit programs.

The Public Housing Program

The Public Housing Program, established by the Housing Act of 1937, was originally intended to house the working poor, improve slums, and provide construction jobs. In recent years, the program has become a vehicle for providing housing for the country's poorest families. The Public Housing Development Program is the component of the Public Housing Program through which housing is developed, either through new construction or the acquisition of previously built housing.

HUD administers the program through approximately 3,400 PHAS across the country. PHAS are state-authorized entities whose primary mission is to manage the nation's public housing stock. The Public Housing Program provides selected PHAS with grants to cover virtually all the costs they incur when developing units. In 1991, the Congress appropriated about $734 million for developing additional public housing units and for major renovations of obsolete projects.

HUD oversees and closely regulates most of the process by which PHAS develop additional public housing units. After HUD selects a PHA to receive public housing development funds, PHA staff select housing sites, types of units, and other characteristics of the projects, within the constraints of program guidelines. HUD staff review each step the PHA takes in developing public housing. HUD also restricts how much a PHA spends to develop each unit through prescribed limits on total development costs. Within a geographic area, the restrictions vary only by the number of bedrooms in a unit and the type of structure developed.

After public housing units are completed, HUD continues to regulate PHAS' selection of tenants and operation of units. HUD generally requires that PHAS fill newly developed units with tenants who have incomes below 50 percent of the median income for their area and that preference be given to certain types of households, such as those paying more than 50 percent of their income in rent. Because most public housing tenants can afford to pay very little in rent, HUD provides PHAS with ongoing operating subsidies to compensate for the deficit between operating costs and tenant rents. According to HUD guidelines, rents may generally not exceed 30 percent of tenants' income.

The Low-Income Housing Tax Credit Program

The Low-Income Housing Tax Credit Program was authorized in the Tax Reform Act of 1986 to provide an incentive for investors to rehabilitate and construct low-income housing. The tax credit replaced other tax incentives, such as special accelerated depreciation, that were eliminated by the 1986 act. Since the credit was established, it has emerged as the primary tax incentive for stimulating low-income housing construction and rehabilitation. Although its authorization expired in June 1992, the tax credit program may be reauthorized in 1993.

The program is administered by the Department of the Treasury and state tax credit allocation agencies. State tax credit allocation agencies review applications from, and award tax credits to, housing developers. The program is intended to be used primarily by private for-profit and nonprofit housing developers, although it has also been used by a small number of PHAS. HUD reviews tax credit projects that involve other types of federal subsidies to ensure that the combined assistance awarded is not more than necessary to make the project viable. The program provides a 10-year tax credit, subject to eligibility criteria, to project investors for each unit set aside for at least 15 years of use by low-income households.

Because developers such as PHAS and nonprofit organizations have no tax liabilities against which to apply a tax credit, they form limited partnerships, usually through syndicators, with corporations or other private investors with tax liabilities that could be reduced through a tax credit. When the partnership is formed, the investor contributes cash in return for the tax credits and other associated tax benefits the project is expected to provide. In this way, the developer converts its tax credit allocation into cash that can be applied toward the costs of developing the units. In a limited partnership, the developer is considered the "general partner," with responsibility for developing and managing the units, and the investors are considered the "limited partners," with responsibility for providing up-front cash in return for annual tax benefits. Until the tax credit expires, the investors own the units developed with the tax credit.

PHAS may also use the tax credit by working with private for-profit and nonprofit housing developers. Some states permit PHAS to function as the general partner in tax credit projects. However, PHAS involved with the tax credit in other states form nonprofit subsidiaries or work with existing private developers that serve as general partners.

As limited partners, the investors in tax credit projects share in any profit or loss incurred while operating the project. Accordingly, limited partners can deduct project losses, in addition to applying the tax credit, from their income tax returns. Although corporate investors can claim an unlimited amount of these deductions, the amount claimed by individual investors is subject to limitations if they have no income to claim from other rental property.

The amount of the tax credits awarded to each project is based on the cost of developing the units. For newly constructed housing and qualified rehabilitated housing that does not receive other federal subsidies, the credits may have a present value of up to 70 percent of the eligible cost of the low-income units. A reduced credit with a present value of up to 30 percent is available for certain subsidized housing and for the purchase of existing housing that is rehabilitated.

Because tax credits are not intended to cover the full cost of developing units, developers must obtain supplemental funds, such as conventional loans and state subsidies. Some PHAS also obtain HUD Section 8 rental assistance to help defray operating costs and debt service on conventional loans when low-income tenants' rents do not cover monthly costs. Only tenants with incomes of less than 60 percent of the median income in an area are eligible to live in units developed with the tax credit. These tenants may not be charged rents greater than 30 percent of this maximum income level.

After they receive the last of their annual tax credits, investors may sell or donate the units to a buyer. The tax credit program requires that after the credit expires, investors must try to ensure that the units will be used for low-income households for an additional 15 years. However, if investors trying to sell the units cannot find such a buyer, the units may be converted to another use. PHAS that develop tax credit housing hope that investors will sell or donate the units to them when the tax credit expires, although guaranteeing such an outcome is not permitted by the tax credit program.

Selected Characteristics of Public Housing and Tax Credit Projects GAO Reviewed

PHA location	Average annual household income: Public housing projects	Average annual household income: Tax credit housing projects	Use of operating subsidies from other federal programs for the tax credit project
Alexandria, Va.	$13,376	$19,126	no
Clackamas County, Ore.	$10,491	[a]	no
Grand Rapids, Mich.	$15,000	<$5,000	yes[c]
Macon, Ga.	$7,417	$5,020	yes
Monterey County, Cal.	$15,096	$9,041	yes
Montgomery County, Md.	$15,899	$23,552	no
Prichard, Ala.	$8,016	$2,901	yes
Sacramento, Cal.	$9,624	$12,156	no
Tulare County, Cal.	$14,520	$8,536	yes

Percentage of households in projects that are elderly		Average household size		Use of single and scattered sites		Predominant income level of neighborhood		Predominant racial composition of neighborhood	
Public housing projects	Tax credit housing projects	Public housing projects	Tax credit housing projects	Public housing projects	Tax credit housing projects	Public housing projects	Tax credit housing projects	Public housing projects	Tax credit housing projects
5%	[b]	2	3	Scattered	Single	Middle	Middle-upper	White	White
11%	4%	4	2	Scattered	Single	Middle	Middle	White	White
0%	0%	4	3	Scattered	Single	Low	Low	Mixed	Minority
0%	30%	5	2	Single	Scattered	Middle	Low	Mixed	Minority
0%	100%	5	1	Scattered	Single	Middle	Middle	Minority	Mixed
0%	10%	4	3	Scattered	Scattered	Middle	Middle	White	White
10%	0%	4	3	Single	Single	Middle	Low	Mixed	Minority
0%	100%	4	1	Scattered	Single	Middle-low	Low	Mixed	Mixed
0%	100%	4	1	Scattered	Single	Middle	Low	Mixed	Mixed

Note: Data provided by PHAs for 1992. We did not verify the PHAs' characterization of households as elderly, projects as scattered- or single-site, and predominant neighborhood income level and racial balance.

[a]PHA was unable to provide exact average household income for this project. However, PHA officials estimated that the income level is higher than that of the public housing project.

[b]PHA was unable to provide the exact percentage of elderly households in this project. However, PHA officials stated that there were some elderly households in the project.

[c]PHA plans to obtain federal subsidies for operating its tax credit project.

Costs Associated With Tax Credit and Public Housing Projects at the HOC of Montgomery County, Maryland

We determined the costs to the federal government of subsidizing the tax credit and public housing projects most recently completed by the HOC and determined which method would be least costly if both projects were used to serve the types of very low-income tenants typically found in public housing. We focused on costs the federal government would incur by providing subsidies to the PHA and tax benefits to investors but did not consider costs incurred by federal agencies for overseeing the public housing and tax credit programs. According to officials at the HOC, the units in both the tax credit and public housing projects are similar. Most of the units in both projects are town homes of equal value scattered throughout market-rate housing developments. The HOC paid about the same purchase price for units developed under both programs.

Like three of the other PHAS we reviewed, the HOC uses its tax credit projects to serve households with incomes that are higher than those of its public housing tenants. PHAS may adopt this practice when they take out loans to cover the development costs not covered by the tax credit. By serving tenants with incomes higher than those of the typical public housing tenants, the project will produce enough rental revenue to cover operating costs and debt service payments without a government operating subsidy. In 1992, the average income of the households in the HOC tax credit project was $23,552. For the same year, the average income of the households in the public housing project was $15,899. The average household size was three for the tax credit project and four for the public housing project. By charging rents on the basis of household income and other factors such as household size, the PHA received average monthly household rents of $437 for the tax credit project and $187 for the public housing project. (See table IV-1.)

Table IV.1: Estimated Costs Per Unit for 15 Years for a Public Housing and a Tax Credit Project at the HOC

	Public housing project ($187/month, 1992 rent)	Tax credit project ($437/month, 1992 rent)
Development sources and uses of funds		
Sources		
Public housing grant[a]	$62,637	$81,406
Interest subsidies[b]	9,327	
Tax credit investor contribution[c]		51,950
Loan amount		25,218
Uses		
Development costs[d]		81,406
Net	0	0
Operating expenses and income		
Expenses		
Operating costs	31,352[e]	30,826
Debt service		19,948
Income		
Public housing operating subsidy	9,806[f]	
Rental revenue	17,381	50,774
Local operating subsidies	4,165	
Net	0	0
Federal government costs		
Public housing grant	62,637	
Public housing operating subsidy	9,806	
Tax benefits to investors[g]		67,224
Total cost	**$72,443**	**$67,224**

(Table notes on next page)

Note: An annual discount rate of 8.25 percent was used to discount amounts. Although the amounts shown are the total payments or revenues collected by the PHA over a 15-year period, each category of payment and revenue did not necessarily continue for 15 years. For example, all development costs were incurred during the first 3 years of the project. Amounts are based on data provided by the HOC.

[a]Although the nine PHAs we reviewed told us that HUD had covered virtually all of the costs of developing their public housing projects, the public housing grant provided to the HOC only covered approximately 87 percent of development costs. The PHA incurred opportunity costs because it purchased the units first and then was reimbursed by HUD several years later.

[b]The PHA provided an implicit subsidy because it covered the development costs from its own reserves initially and then was repaid several years later when (1) HUD provided the public housing development grant for the public housing project and (2) the tax credit investors provided their cash contribution and the PHA obtained a commercial loan for the tax credit project.

[c]Amount represents the total up-front cash the investor contributed in return for the annual tax benefits. This investor had served as the limited partner for the PHA's previous tax credit project.

[d]Development costs include the cost to the PHA of purchasing the units and the estimated administrative expenses the PHA incurred while developing the project. Administrative expenses include lawyer and accountant fees and the PHA's estimates of salary expenses when developing each project.

[e]Estimate based on the average for all of the PHA's public housing stock because the PHA does not maintain project-specific data on public housing operating subsidies.

[f]Estimate based on the average for all of the PHA's public housing stock because the PHA does not maintain project-specific data on public housing operating subsidies.

[g]Amount represents the total estimated federal tax benefits provided to investors. Benefits consist mostly of the tax credit and benefits due to project operating losses. However, this estimate has also been adjusted to reflect a charitable deduction the investor plans to receive after giving the units to the PHA at the end of the credit term and exit taxes that will be paid to the federal government at the end of the credit term. The estimate is based on a series of assumptions about the investor's ability to claim these benefits each year, such as the assumption that the project will incur the level of operating losses planned and that the credit will not be recaptured due to project noncompliance with tax credit program standards.

We computed the federal government's costs for subsidizing the HOC's tax credit and public housing projects. The primary costs the federal government would incur during the first 15 years of the tax credit project would be the annual tax benefits paid for 10 years to investors. The primary costs the federal government would incur during the first 15 years of the public housing project would be the HUD public housing development grant and HUD public housing operating subsidies to the PHA. According to a PHA official, the units in the tax credit and public housing projects are of equal quality. As table IV-1 shows, we estimated that the federal government's costs during the first 15 years could be about the same for a unit in the public housing project as for one in the tax credit project. We estimated that the present value discounted to 1990 of the costs to the federal government during the projects' first 15 years would be about $72,000 per unit for the public housing project and about $67,000 per unit for the tax credit project. These estimates are based on actual costs the federal government incurred before June 1992 and estimated costs the federal government could incur after May 1992.[1]

Because the public housing project served households that were poorer than those in the tax credit project, we estimated the federal government's costs if, in addition to the tax credit, the PHA obtained the Section 8 rental subsidies it would need to serve households as poor as those in public housing. In 1992, the HOC had to charge an average monthly rent of $437 to cover monthly operating costs of about $232 and debt service payments of about $205 for each unit in the tax credit project. Assuming the PHA would face the same operating costs and debt service payments if it served poorer tenants, it would need an additional monthly subsidy of $250 to serve a household that could only contribute $187 in rent each month, like those in the public housing project.

We estimated that federal expenditures for the tax credit project would be substantially higher than the costs of serving the same type of tenants in the public housing project, if the tax credit allocation were supplemented with a monthly federal subsidy of $250 for each unit in the tax credit project. We calculated that the costs to the federal government of providing a monthly Section 8 subsidy of $250 during the project's first 15 years would have a present value discounted to 1990 of about $24,000 for each unit. Since the estimated cost to the federal government of providing only tax credits could be as much as $67,000, the federal government's estimated total cost of providing both Section 8 subsidies and tax credits for the tax credit project could have a present value discounted to 1990 of about $91,000 for each unit in the project during the project's first 15 years. This would be substantially more costly than serving these tenants in the public housing project, which we estimated would only cost the federal government about $72,000 per unit during the project's first 15 years.

[1]In calculating the costs to the federal government of the tax credit project, we assumed that the future allowable tax benefits are certain to be received by the investor. We could not estimate the risk perceived by the investor that the benefits would not be received. Benefits might not be received if, for example, the tax credits are recaptured by the government for project noncompliance with tax credit regulations.

Administrative Experiences of Four PHAs When Using the Two Housing Development Programs

This appendix describes the experiences of the four PHAS we visited with both the tax credit and public housing programs.

The Public Housing Program

The administrative obstacles the PHAS experienced when developing public housing projects centered on HUD's public housing regulations and procedures. These problems were cited by the four PHAS we visited as well as the Council of Large Public Housing Authorities. According to the four PHAS, they experienced the greatest difficulties with HUD's site-selection criteria, appraisal requirements, limits on costs for development activities, and turnaround of the many forms PHAS are required to submit during the development process.

Officials at two of the PHAS explained that HUD's site-selection criteria hampered the development of their public housing projects. In one case, PHA officials stated that HUD's neighborhood impaction restrictions and emphasis on scattered-site development made it difficult and time-consuming for them to select sites for the public housing project because local land costs were very high. HUD's impaction restrictions prohibit PHAS from developing additional public housing units in neighborhoods that already contain a high percentage of federally subsidized households or minority households. HUD also promotes development of public housing on scattered sites rather than on a single site. These requirements are intended to avoid further concentration of disadvantaged households in single neighborhoods. In the other case, HUD's regulations prohibiting sites on flood plains or where there is excessive noise pollution made site selection very difficult for a PHA located in an area with very little undeveloped land.

Two of the PHAS experienced substantial difficulties while developing public housing because of property appraisal disagreements with HUD. For one PHA, HUD's rejection of property appraisals caused serious delays in the acquisition process when it acquired existing housing units from private sellers. According to the PHA, HUD unreasonably rejected appraisals that were prepared by an appraiser HUD had recommended and that were within HUD's prescribed limits for the total cost of development.

These same cost limits presented obstacles for three PHAS we visited during the development of their public housing projects. These limits are intended to control the amount of funds spent to develop public housing projects. For one PHA, the cost limits were too low to accommodate the extremely high price of land in its area. Furthermore, the PHA said that obtaining waivers to allow it to use its own funds to supplement HUD's funds was an arduous process.

All four of the PHAs we visited found HUD's paperwork procedures aggravating or time-consuming. Some of the PHAs said they experienced substantial delays in obtaining approvals from HUD once they had submitted required forms.

The Low-Income Housing Tax Credit Program

According to the four PHAs we visited, it is often difficult to obtain the additional funds needed to develop and operate housing financed by the tax credit program. Three of these PHAs explained that the level of per-unit subsidy provided by the tax credit was insufficient to serve the poorest households in their communities. If the cash provided by investors is not sufficient to cover the costs of developing the project and the PHA needs to take out a loan, then the project must serve tenants who can provide enough rent to cover debt service and operating costs or the PHA must obtain operating subsidies through another program, such as HUD's Section 8 program. To cover development and operating costs, the four PHAs we visited used supplemental funds, such as loans, state tax credits, and Section 8 subsidies. The process of obtaining these supplemental funds can be arduous, the PHAs explained. Two PHAs had difficulty finding a bank willing to provide a conventional loan to supplement the funding provided through the tax credit. Three of the PHAs found using subsidies from other government programs to supplement the tax credit cumbersome because each additional subsidy required compliance with another set of regulations, which sometimes were difficult to reconcile with the tax credit's regulations.

In addition, the involvement of a variety of participants, such as attorneys and investors, make use of the tax credit more difficult, according to the four PHAs we visited. Each PHA hired contractors, such as real estate and tax attorneys, to meet the financial demands of the tax credit program. For two of the PHAs, finding tax credit investors was a burdensome task. According to one PHA, providing the amount of information and assurance about the activities and financial viability of the PHA required by potential investors was difficult and time-consuming. Because of difficulties in finding investors, it took another PHA 2 years to find an investor.

Comments From the Department of Housing and Urban Development

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
THE SECRETARY
WASHINGTON, D.C. 20410-0001

March 30, 1993

Ms. Judy England-Joseph
Director, Housing and Community
Development Issues
U.S. General Accounting Office
Washington, DC 20548

Dear Ms. England-Joseph:

This is in reply to your request for comments on your draft report entitled "Public Housing: Low-Income Housing Tax Credit as an Alternative Development Method."

Section 526 of the National Affordable Housing Act of 1990 (P.L. 101-625) directed the General Accounting Office (GAO) to review different methods of developing publicly controlled housing units. The purpose of the review was to compare the development of low-income housing under the low-income housing tax-credit method with the public housing development program.

I am pleased to provide the enclosed staff comments. Thank you for affording the Department the opportunity to review and comment on this significant GAO Report for Congress.

Sincerely,

Henry G. Cisneros

Enclosure

U. S. Department of Housing and Urban Development
Washington, D.C. 20410-5000

MAR 9 1993

OFFICE OF THE ASSISTANT SECRETARY
FOR PUBLIC AND INDIAN HOUSING

MEMORANDUM FOR: Michael B. Janis, General Deputy Assistant Secretary for Public and Indian Housing, P

FROM: ~~Janice D. Rattley~~, Director, Office of Construction, Rehabilitation and Maintenance, PC

Janice D. Rattley

SUBJECT: GAO Report: "Public Housing: Low-Income Housing Tax Credit as an Alternative Development Method"

This is to provide comments regarding the subject draft General Accounting Office (GAO) report.

On the basis of the experience of nine public housing agencies (PHA), which had developed housing projects under both the public housing and tax credit programs, GAO came to several conclusions:

- PHAs were able to develop housing quicker using the tax credit approach than under the public housing program (from 1 1/2 to 2 1/2 years quicker) because the public housing procedures were more burdensome.

- Housing developed by PHAs under the tax credit approach served smaller (frequently elderly) households, and was typically on single sites located in minority, low-income neighborhoods.

- PHAs that developed housing with tax credits must serve higher income households than under public housing because it was necessary to obtain loans for development costs not covered by the tax credit programs.

- If housing developed under the tax credit program served households as poor as those in public housing, it would be more expensive for the Federal government.

- Although in some cases, PHAs felt it was easier to develop public housing, they expect to develop more housing using tax credits because it is one of the few ways currently available to develop housing for low-income households.

2.

See comment 1.

The study was conducted in an objective manner and it has raised a number of issues which deserve continuing analysis. Those issues include, but are not limited to the following:

See comment 2.

- - While the study indicates that housing can be produced more quickly through the tax-credit approach, the speed is accomplished due to a lack of cumbersome regulations, e.g., site and neighborhood standards. A larger question that emerges from this, however, is what are projected as social impacts on communities if such housing is undertaken in any large scale manner as a supplemental development tool by a given PHA, especially in the larger urban areas?

See comment 3.

- - The study cites the fact that one of the reasons the tax-credit approach is more costly is the presence of high administrative expenses experienced by PHAs. Is it reasonable to expect that such expenses would decline over time as Authorities gain experience with the program? Or as assistance to PHAs, would it appear reasonable for Treasury and or HUD to develop "model" forms and procedures to facilitate the use of this avenue and thus reduce expenses? Would this make the cost more comparable to public housing?

See comment 4.

- - None of the nine PHAs used for the study were large PHAs; have any large PHAs developed housing with tax credits? If not, why not?

See comment 5.

- - The relatively short tax credit period may have significant adverse consequences for occupants (particularly elderly households) of housing developed by this method. What projections if any, were there for renewal of the credit for previously approved sites?

See comment 6.

As noted above, the Report cites specific administrative obstacles that PHAs experienced when developing public housing projects. According to the PHAs that were interviewed, the greatest difficulties related to HUD site selection criteria, appraisal requirements, limits on development costs, and HUD's turnaround of the many forms PHAs must submit during the development process. It is recognized that these factors represent obstacles in the development of public housing; however, in some cases, the obstacles are statutory. For example, with regard to appraisal requirements and cost limits, these provisions are based on statutory requirements. There is no question that PHAs are subjected to many HUD reviews/approvals during the development of public housing; in this connection, a regulation change will soon be published for comment that proposes to authorize a Field Office to exempt a PHA from certain HUD reviews and approvals.

3.

In conclusion, we believe that additional analysis should be performed to allow this Department, in conjunction with the Department of Treasury, to decide the most appropriate steps needed to assure that the low-income population is served in the most cost-beneficial way possible. We would welcome discussions on this matter.

U. S. Department of Housing and Urban Development
Washington, D.C. 20410-6000

March 12, 1993

OFFICE OF THE ASSISTANT SECRETARY
FOR POLICY DEVELOPMENT AND RESEARCH

MEMORANDUM FOR: John J. Conners, Deputy Inspector General, ZD

FROM: Lawrence L. Thompson, General Deputy Assistant Secretary for Policy Development and Research, T

SUBJECT: GAO Report: "Public Housing: Low-Income Housing Tax Credits as an Alternative Development Method"

I apologize for the lateness of these comments. Unfortunately, we were not included among the reviewers of the subject report and became aware of the report only when we reviewed the Department's response. We would like to add three comments to those provided by the original reviewers.

See comment 7.

(1) The report should emphasize more fully how syndication costs affect the cost efficiency of the low-income housing tax credit. In PD&R's 1992 study, syndication costs were found to reduce the funds raised from tax credits by an average of 13.8 percent to 22.9 percent depending on the type of syndication. This inefficiency follows directly from the method used to subsidize these projects; i.e., the selling of tax benefits. It is difficult to substantially reduce this inefficiency without changing the subsidy mechanism.

See comment 8.

See comment 9.

See comment 10.

(2) The report correctly notes that tax credit projects do not normally serve households with incomes as low as those in public housing. However, this observation should be qualified in two ways. First, the PD&R study found that approximately 27 percent of low-income housing tax credit projects built from the 1987 and 1988 allocations had no other source of assistance and that many of these projects served a clientele with incomes substantially below the 60 percent of median income maximum. Second, the GAO report does not mention whether any of the projects in the nine PHAs benefitted from the extra tax credits available for projects located in qualified census tracts. Projects in qualified census tracts receive up to 30 percent more credits and therefore can serve a lower income clientele.

See comment 11.

2

(3) While combining the low-income housing tax credit with other subsidies, such as Section 8, will enable projects to serve lower income households, these combinations create the subsidy layering problem which has been a major concern for both HUD and the State housing finance agencies which administer the tax credit. Both the low-income housing tax credit and Section 8 were designed to operate as self-standing programs, therefore combining them will in general lead to over-subsidization unless special care is taken to eliminate any excess subsidy.

U. S. Department of Housing and Urban Development
Washington, D.C. 20410-3000

FEB - 9 1993

OFFICE OF THE ASSISTANT SECRETARY
FOR ADMINISTRATION

MEMORANDUM FOR: John J. Connors, Deputy Inspector General, ZD

FROM: Herbert G. Persil, Director, Office of Budget, AB

SUBJECT: Comments on GAO Report on Low Income Housing Tax Credit

This draft GAO report compares the Low Income Housing Tax Credit as a method of providing housing for low income tenants to Public Housing Development. The report seems to favor Public Housing Development. However, there are several arguments in favor of the low income housing tax credit that the report fails to make. It has been the policy of previous Administrations to emphasize existing housing rather than new construction. However, a tax credit seems to be the only way to entice developers to use housing for Section 8 Existing Certificates and Vouchers. There is no economic incentive, without the tax credit, to turn units that are occupied at market rate rent into low income housing, no matter how many vouchers and certificates you put out there. Additionally, the report makes the case, on p. 9, that Public Housing serves large families more than Section 8 housing does - that it concentrates more on the elderly. Although they surveyed 333 units of public housing and 543 units of existing housing, their data is not representative. According to our records, national data show that 33 percent of public housing tenants are elderly and 37 percent of Section 8 tenants are elderly (see attached charts).

See comment 12.
See comment 13.

Now on p. 7.
See comment 14.
See comment 15.

On p. 10 the report states that tax credit projects need subsidies to operate as low income projects. This, of course, is exactly the type of project for which Section 8 subsidy was designed. Then they state that tax credit projects are not subject to HUD regulation. They are if they enter the Section 8 program. And unless a builder were assured of Section 8 subsidy, he is highly unlikely to enter the tax credit program at all.

Now on p. 7.
See comment 16.
See comment 17.

GAO's review was limited to PHAs that had both tax credit projects and public housing. Of the 3,300 PHAs in the United States, they only found nine that met this criteria, most of them in wealthy areas. Given the fact that the tax credit program has only been in existence since 1986 (there were other incentives for private development of low income housing before the overhaul of the tax code in 1986), this hardly seems like a large enough sample or a long enough time period on which to base a negative evaluation.

See comment 18.

2

However, this matter more appropriately should be addressed by Public and Indian Housing and we defer to the program office on this issue.

Attachments

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PRJSTS          MULTIFAMILY TENANT CHARACTERISTICS SYSTEM      02/08/93  10:28:10
                   LOWER INCOME PUBLIC/INDIAN HOUSING
                      ***     US  STATISTICS   ***   AS OF 12/92

    US SUMMARY

 ********AVERAGES********************        **************TOTALS**************
 UNIT UTILITY ALLOWANCE:    $ 30                ADMISSIONS REPORTED:   155560
     NUMBER OF BEDROOMS:      1.9           REEXAMINATIONS REPORTED:   925200
         HOUSEHOLD SIZE:      2.5               WHITES/NON-HISPANIC:   378563
             DEPENDENTS:      1.1               BLACKS/NON-HISPANIC:   488457
    LENGTH OF OCCUPANCY:     90 MONTHS      AMERICAN INDIAN/ALASKAN:    40241
      INCOME PER FAMILY: $ 7252              ASIAN/PACIFIC ISLANDER:    20607
                MEDICAL: $  268                            HISPANIC:   152892
             CHILD CARE: $   53
    HANDICAP ASSISTANCE: $    8                         NON-ELDERLY:   591075
      NET FAMILY ASSETS: $ 1599                         62 OR OLDER:   351259
         TENANT PAYMENT: $  160               DISABLED/HANDICAPED:    138426

                         PROJECT NO.                      _ << PRINT
PROJECT DETAIL:  PRJDTL ___________         MTCSIQ _ << PRIOR SCREEN
                 PRJ/HA/REG/RO/ST/US  P/I/C ADM. YYMM
    STATISTICS:  PRJSTS ___________   _   _   ____  _      MENU  MTCSMN   _
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Admissions reported	155,560
Reexaminations reported	925,200

Total surveyed	1,080,760
Elderly	351,259
Elderly as a percent of total	32.5%

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PRJSTS          MULTIFAMILY TENANT CHARACTERISTICS SYSTEM     02/08/93   10:25:33
                   LOWER INCOME PUBLIC HOUSING
                      ***     US  STATISTICS  ***   AS OF 12/92

    US SUMMARY

 ********AVERAGES*******************       **************TOTALS**************
 UNIT UTILITY ALLOWANCE:    $ 27                 ADMISSIONS REPORTED:  149759
     NUMBER OF BEDROOMS:      1.8            REEXAMINATIONS REPORTED:  893584
         HOUSEHOLD SIZE:      2.4                WHITES/NON-HISPANIC:  376312
             DEPENDENTS:      1.1                BLACKS/NON-HISPANIC:  488165
    LENGTH OF OCCUPANCY:     91 MONTHS       AMERICAN INDIAN/ALASKAN:    5597
      INCOME PER FAMILY: $ 7067               ASIAN/PACIFIC ISLANDER:   20581
                MEDICAL: $  276                             HISPANIC:  152688
             CHILD CARE: $   51
    HANDICAP ASSISTANCE: $    8                         NON-ELDERLY:  561012
      NET FAMILY ASSETS: $ 1646                         62 OR OLDER:  346201
         TENANT PAYMENT: $  160                  DISABLED/HANDICAPED:  136130

                      PROJECT NO.                        _ << PRINT
PROJECT DETAIL:  PRJDTL ___________  _       MTCSIQ _ << PRIOR SCREEN
                 PRJ/HA/REG/RO/ST/US  P/I/C ADM. YYMM
    STATISTICS:  PRJSTS ___________   _   _   ____  _     MENU   MTCSMN   _
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Admissions reported	149,759
Reexaminations reported	893,584

Total surveyed	1,043,343
Elderly	346,201
Elderly as a percent of total	33.2%

The following are GAO's comments on the memorandums submitted by HUD on March 30, 1993.

GAO's Comments

1. We agree that this report raises these and other issues that deserve continuing analysis. We did not address these issues in this report for the reasons explained in comments 2 to 5.

2. We did not project the social impacts on communities if PHAS used the tax credit on a large scale because of the limited scope of our review. We reviewed only tax credit projects developed by the nine PHAS that had also recently developed public housing. In this way, we could compare tax credit and public housing projects developed under similar local conditions. Because our scope was limited to these nine PHAS, we cannot make projections in this report about the effects of large-scale use of the tax credit by PHAS.

3. Although it may be reasonable to expect the administrative costs of using the tax credit to decrease as PHAS gain experience with the program, we did not examine this in our study for several reasons. First, we were asked to examine the program only 4 years after it had been enacted—a period of time too short for PHAS to gain much experience with it. And second, our objective was to compare a single tax credit project with a public housing project at each of the PHAS we reviewed. Consequently, we collected information only on one tax credit project that each PHA had developed, not on any previous tax credit projects that they might have developed. We did not estimate how "model" forms and procedures might affect administrative costs because our objectives were to compare outcomes of the two programs, not remedial steps that might be taken to alter these outcomes.

4. The National Association of Housing and Redevelopment Officials classified PHAS with more than 1,250 units as "large PHAS." Only 12 PHAS that responded to the survey conducted by this association had participated in the tax credit program and had at least 1,250 units. We included three large PHAS—the Housing Opportunities Commission of Montgomery County, Maryland; the Macon Housing Authority, Georgia; and the Sacramento Housing and Redevelopment Agency, California—among the nine PHAS we reviewed because they had recently developed housing through the public housing program as well as the tax credit program.

5. As stated in the report, investors may sell or donate units developed under the tax credit program to a buyer after the 10-year tax credit term, at which time investors must try to ensure that the units will be used for low-income households for an additional 15 years. However, if such arrangements cannot be made, the units may be converted to another use. Although we did not project how long the nine PHAS we reviewed would be able to use tax credit projects for low-income tenants, six PHAS believed that the investors in their projects would probably sell or donate the units to them when the tax credit expired. However, guaranteeing such an outcome is not permitted by the tax credit program.

6. We agree that some of the obstacles PHAS told us they faced when developing public housing may be due to statutory requirements, and we revised the report to explain that we did not determine which obstacles were due to statutory requirements and which were due to HUD's administration of the public housing program. Furthermore, we did not address proposed regulatory changes because this report focuses on PHAS' perceptions about their experiences in developing housing before 1991.

7. We revised the report to include the information on syndication costs presented in the HUD study.

8. This report does not state that "tax credit projects do not normally serve households with incomes as low as those in public housing." It states that, of the nine PHAS we reviewed, only PHAS that used, or planned to use, federal operating subsidies served households with incomes as low as those in their public housing projects.

9. We agree that some tax credit projects serve low-income clientele without federal operating subsidies. The report shows that four of the nine PHAS we reviewed did not use federal operating subsidies for their tax credit projects.

10. We did not determine if the nine PHAS in our study were in qualified census tracts and therefore eligible for additional tax credits. Instead, we collected information on the total amount of funding PHAS received through the tax credit program and the income of households in their tax credit projects. The total amount of funding the PHAS receives includes any additional tax credits awarded.

11. Although we did not determine whether oversubsidization occurred when PHAS combined tax credits with Section 8 subsidies, we did

determine that only PHAs that combined tax credits with Section 8 subsidies or other federal operating funds were able to serve households with incomes as low as the households in their public housing projects.

12. This report presents information on tax credit and public housing projects developed by the nine PHAs we reviewed. Readers may interpret some of the information presented about these projects as favorable to the public housing program. For example, during our case study at one PHA, we found that the federal government is spending about the same for the tax credit and public housing projects, even though the public housing project serves households with much lower incomes. However, other information presented in the report may appear favorable to the tax credit program. For example, we found that for the two PHAs we visited that had comparable data, the tax credit program enabled projects to be developed much faster than did the public housing program.

13. This argument is not relevant to our study because we did not review development undertaken by private developers. Our review focused on development by PHAs—agencies created expressly for the purpose of developing and managing low-rent housing. Because of their mission, PHAs do not need the same market incentives needed by private for-profit developers to develop housing for low-income households. Furthermore, we found that the public housing program facilitated the acquisition of existing units for low-income housing as much as the tax credit program at the nine PHAs we reviewed. Four of the PHAs developed their public housing projects by acquiring existing units, and three developed their tax credit projects by acquiring existing units.

14. The report does not state that public housing serves large families more than Section 8 housing. It states that most of the nine PHAs we reviewed used their public housing projects to serve larger households than those served in the tax credit projects.

15. We agree that the information we collected at the nine PHAs is not representative of the universe of public housing or tax credit projects. As stated in the report, we reviewed only projects at the nine PHAs that had recently developed both tax credit and public housing projects to enable us to compare projects developed under similar local conditions. According to HUD's records, about 33 percent of the tenants in all public housing projects are elderly. However, only 2 percent of the tenants in the nine recently developed public housing projects we reviewed were elderly. This disparity is consistent with the information presented in the report.

The report states that in 1983, according to a HUD official, the public housing development program was revised to discourage development of public housing for the elderly. Consequently, it is not surprising that recently developed projects serve fewer elderly tenants than all public housing projects. Furthermore, HUD's data about elderly tenants in Section 8 units are not relevant to our study because our report compares public housing projects and tax credit projects, not public housing projects and Section 8 projects.

16. The report does not state that tax credit projects need subsidies to operate as low-income projects. It states that the tax credit projects needed operating subsidies from other federal programs to serve households with incomes as low as those of the households in the public housing projects at the nine PHAS we reviewed. The report also states that only tenants with incomes of less than 60 percent of an area's median income are eligible to live in units developed with the tax credit. Although five of the PHAS we reviewed used federal operating funds, such as Section 8 subsidies, for their tax credit projects, four were still able to serve low-income households in their tax credit projects without federal operating subsidies.

17. Although HUD regulates Section 8 units, it does not regulate the process of developing these units as it does public housing units. The report has been revised to reflect the fact that the development of tax credit projects is not subject to HUD review.

18. We selected these PHAS because (1) the statutory mandate for this study required that we evaluate the tax credit as an alternative method of developing publicly controlled housing and (2) we wanted to compare development through the tax credit and public housing programs conducted under similar local conditions. We could not postpone conducting our study until the tax credit program had been in existence longer because the Congress mandated the study. The mandate resulted from congressional deliberations about the degree to which the tax credit program might achieve outcomes similar to the public housing development program.

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