A Tax Credit Turns 30.

The low-income housing tax credit (LIHTC) has helped house millions, and it remains a vital driver of development. The 30-year track record of the LIHTC offers compelling evidence that affordable housing is good business, a stable asset class, and a strong driver of economic activity and neighborhood improvement.

Among the myriad ways the U.S. Internal Revenue Code affects commercial real estate is through a federal tax incentive that has become the most important tool to develop and rehabilitate affordable housing: the LIHTC. Since 1986, it has attracted enough private equity to produce nearly 3 million apartments for working-class families, seniors, and formerly homeless individuals. When one looks back over a generation of housing tax credit activity, several themes of importance to the entire real estate industry emerge:

Affordable housing can be a smart real estate investment. A 2015 survey of the housing credit throughout its history by New York City–based professional services firm CohnReznick found that equity investors have realized 98 percent of their anticipated federal tax credits (dollar-for-dollar reductions in federal income taxes owed) through calendar year 2014. The report also noted that yields on housing credit fund investments have maintained a healthy premium over yields on ten-year Treasuries, “with an approximate 400-basis-point buffer since 2011.”

Affordable housing can be a viable development opportunity. Contrary to popular perception, most LIHTC-supported and other affordable developments are delivered by for-profit firms. According to a 2016 paper from Harvard University’s Joint Center for Housing Studies, for-profit companies among the largest 50 developers were responsible for 79 percent of all affordable housing starts between 2009 and 2014. Nonprofit developers also are important players in LIHTC-supported development. Various studies have shown that both for-profit and nonprofit sponsors execute LIHTC-supported developments of similarly high quality and financial performance.

Affordable housing is a significant driver of overall multifamily construction activity. The housing tax credit drives the creation of roughly 50,000 new units per year—a significant share of overall multifamily development activity even during the current boom in new apartment construction. The LIHTC also supports the rehabilitation of another 50,000 existing units. The Washington, D.C.–based National Association of Home Builders estimates that the LIHTC annually generates 95,700 jobs; $3.5 billion in federal, state, and local tax revenue; and $9.1 billion in wage and business income.

Affordable housing development can strengthen struggling areas. Housing credit properties are found in many types of neighborhoods and usually—if not always—provide higher-quality housing than their residents could otherwise afford or access. A working paper from the National Bureau of Economic Research found that LIHTC-supported development delivers significant impact at the community level as well: each LIHTC-supported development in a low-income area generates aggregate benefit in the neighborhood of $116 million, increasing surrounding home prices by 6.5 percent (which boosts the local tax base) and lowering crime rates.

Housing credit development and management face challenges, however. Industry participants agree that total development costs for LIHTC-supported properties in some markets are high in relation to existing affordable units, and even some market-rate homes, for reasons that include higher construction quality and excessive state and local regulatory requirements.

The CohnReznick report found that 17 percent of LIHTC-supported properties operated below breakeven (a debt-coverage ratio less than one), but noted that this percentage is way down from ten years prior and that "the great majority of properties that did not achieve breakeven operations in 2014 failed to do so by relatively modest amounts." Analysis by certified public accountants Novogradac & Company, based in Bethesda, Maryland, has shown that net operating income as a percentage of total rental income had declined annually from 2010 through 2013 for LIHTC-supported units, with a small upward rebound in 2014, which slightly reversed a negative trend.

The biggest challenge facing the housing tax credit, though, is the overwhelming demand for the housing it enables developers to produce, which vastly exceeds the amount of tax credit authority available to states every year. In a broader housing market where supply is probably 3 million units short of demand, according to industry estimates, low-income renters—including millions filling critical jobs in the workforce such as teachers, nurses, firefighters, and police officers—are paying half or more of their income for housing, living in substandard units, and sacrificing on other basic needs to pay their rent.

An expanded LIHTC would help ease that crunch. Senators Maria Cantwell (D-Washington) and Orrin Hatch (R-Utah) have introduced a bill to increase credit authority by 50 percent. The proposed legislation would help create or preserve approximately 1.3 million affordable homes over a ten-year period—an increase of 400,000 more units than is possible with current authority. Efforts expected by Congress next year to reform the tax code could create an opportunity to enact the proposal. Tax reform could also endanger the credit or weaken its effectiveness, according to industry experts.

The 30-year track record of the LIHTC offers compelling evidence that affordable housing is good business, a stable asset class, and a strong driver of economic activity and neighborhood improvement. Regrettably, it is also a basic foundation for family success that a growing number of Americans cannot access.

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