CapitalMatters

Central Planning Disguised as Housing-Tax Credits

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March 15, 2024

Housing affordability has become a top issue, and there are many efforts to expand federal subsidies. The Tax Relief for American Families and Workers Act, which has passed the House of Representatives and now awaits action in the Senate, would expand the low-income housing tax credit (LIHTC). There are also bipartisan bills to add a middle-income version of the credit, while President Biden is supporting LIHTC expansion and a raft of other new housing subsidies.

The LIHTC is wasteful and ineffective, and expanding housing subsidies would just multiply the failures. The credit is supposed to boost apartment-building construction, but it displaces market-based projects and mainly benefits developers and financiers, not low-income tenants. The LIHTC also attracts fraud and corruption.

The worst feature of the LIHTC is its intense complexity. Each year, the federal government allocates more than $13 billion of the credits to state governments, who then hand them out to favored developers. The states issue annual "qualified allocation plans" (QAPs) that developers follow to receive the credits.

The QAPs are central-planning documents. Virginia's QAP manual, for example, is 232 pages long and specifies rules for building locations, minority and women subcontractors, developer finances, allowable costs, materials used, accessibility, community-room features, and many other things. The QAPs micromanage housing-unit details such as bathroom fans, faucets, shower heads, windows, energy sources, and even the number of USB charging ports.

There is a layer of federal LIHTC regulations on top of the state QAP rules, and the IRS audit guide for the LIHTC is 350 pages long. There are 15 other types of federal subsidies that may need to be coordinated on LIHTC projects, according to the Virginia QAP.

And the complexity doesn't end there. After LIHTC apartment projects are built, they must be monitored for tenant mix, income levels, and other items for 30-year periods. The California compliance manual for such monitoring is 145 pages long. A final bureaucratic cost is that governments must audit LIHTC projects because of extensive fraud problems.

If you are a developer wanting to tap the LIHTC subsidies, the Novogradac law firm can help. It publishes a LIHTC Handbook that is 1,798 pages in length! All those rules are for a single tax credit.

Federal politicians often claim that they are for tax-code simplification, yet there is bipartisan backing for expanding the LIHTC and adding new housing-tax subsidies. Republicans may think that the LIHTC is a simple tax cut, but it is actually a massive regulatory scheme that centrally plans homes down to the number of USB ports.

According to many studies, the regulatory complexity results in LIHTC projects costing far more to build than market-based projects. The Terner Center for Housing Innovation at Berkeley found that prevailing wage laws in California tied to many LIHTC projects increased the average cost of projects from about $400,000 per unit to about $500,000. One recent LIHTC project in Chicago cost $898,000 per unit to complete.

Policy-makers are rightly concerned about the need for affordable housing. But LIHTC expansion and Biden's proposed new housing subsidies would create more costly complexity. For example, Biden and a bipartisan group in Congress are pushing a new "Neighborhood Homes Tax Credit," which would use the same QAP central-planning approach as the LIHTC to subsidize developers of owner-occupied homes.

Federal subsidies are not the answer for affordable housing. Rather, state and local governments should liberalize zoning and building-code regulations to spur market-based development. One study in 2022 estimated that regulations account for 41 percent of the costs of multi-family housing development. Each individual regulation may be well-meaning, but the cumulative effect is to kill affordability at the bottom end of the market.

State and local governments should also slash property taxes on apartment buildings. On average, property taxes on apartments are 44 percent higher than on single-family homes, a burden that ultimately lands on tenants in the form of higher rents. It is both unfair and bad economics to penalize apartment dwellers compared to homeowners.

Federal policy-makers go astray when they use subsidies to address problems created by state and local governments. The LIHTC is a complex non-solution to a crisis that should be solved by state and local deregulation and property-tax cuts.

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