DIVERSE PERSPECTIVES ON CRITICAL ISSUES

Housing Incentives Stimulate the Private Sector

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Federal incentives encourage private sector housing construction for rental and ownership.

This paper discusses efforts to create incentives for privately built housing in American cities. It addresses both affordable housing and market-rate housing; the income range runs from "low- and moderate-income" to "middle-income." The low end of this range overlaps with some housing assistance programs.

The paper focuses on four categories of incentives: (1) the low-income housing tax credit (LIHTC), the most important rental-housing production incentive; (2) federal homeownership incentives; (3) mixed-income housing, which can be either rental or owner-occupied; and (4) the two major federal block grant programs to promote housing and community development, the Community Development Block Grant (CDBG) and HOME Investment Partnerships. The

The Low Income Housing Tax Credit has a 20-year track record with the private sector.

The LIHTC was created in 1986 to encourage production and rehabilitation of rental housing for families with low or moderate incomes. It was intended to replace the tax incentives for private production of such housing that were eliminated in the Tax Reform Act of 1986. The credits are allocated to the states by formula; the states administer the program, and select projects competitively.

The LIHTC is designed to serve lower-income households primarily, but not exclusively. Incomplete program data indicate that perhaps 90 percent of units are classified as "low-income."[1] Research on the program's early years finds that units were on average within reach of households at 50 percent of area median income (the definition of "very low income"), but could not serve poor people without substantial additional subsidy.[2] Data on recipient incomes indicate that most probably are receiving vouchers.[3]

The development cost per unit averaged about $105,000 (in today's dollars) during the LIHTC's first 10 years (excluding Section 515 Rural Housing Service projects). This implies that about half of all LIHTC units were affordable only to families whose incomes were "low but not very low" (51 to 80 percent of area median income), or "moderate" (above 80 percent, but probably below 120 percent). Thus, LIHTC projects can provide affordable or even market-rate rental housing, though this is not their main purpose.

The LIHTC is not directed specifically to cities, but it does include incentives that effectively encourage development in cities. The credit is 30 percent greater in certain locations, defined in terms of resident income and housing costs: Qualified Census Tracts (where 50 percent of residents have incomes below 60 percent of the area median income) and Difficult To Develop areas, with high housing costs relative to resident incomes. Almost half of all LIHTC units are located in central cities.

Nearly all the central city projects are in low- and moderate-income areas. Thus, the LIHTC has been used largely to provide better housing in poor neighborhoods, rather than affordable housing in higher-income communities. It may therefore contribute to the revitalization of poor neighborhoods, but the income limits place an upper bound on its impact. In some neighborhoods, LIHTC projects are the only new housing; in most, however, there has been other construction.[4] The LIHTC can be part of a revitalization strategy, but not the only housing component, if the intention is to appeal to moderate- and middle-income households.

Homeownership strategies promote revitalization in older cities.

The stereotype of cities as the home of low-income renters is increasingly out of date. The dramatic increase in homeownership nationally has been paralleled in central cities. As the national rate increased from 63.3 percent of all households in 1965 to a record 69.0 percent in 2004, so also the central city homeownership rate increased from 48.0 percent to a record 53.1

percent over the same period. More than half of all central-city residents own their own home, and their number is increasing.

Even in the cities of the Northeast and Midwest homeownership is increasingly important. A convenient grouping is the "old big league cities," the 18 cities in the area bounded by Boston, Washington, D.C., St. Louis, and the Twin Cities that have a team in one of the major sports; this classification turns out to have a minimum size threshold for the metropolitan area of 1.25 million people.[5] In the 1990s the combined population of these cities increased by 2.5 percent, while the number of homeowners grew twice as fast, by 5.1 percent. As a result the share of all households in these cities owning their own home increased from 40.6 percent to 41.6 percent. The share rose in all cities except Philadelphia and Pittsburgh. In Washington, D.C., the population declined by 5.7 percent, but the number of homeowners rose by 4.1 percent.

do not target HOME toward improving poor neighborhoods or reducing the concentration of the poor. HOME is not explicitly used to promote either neighborhood revitalization or mixed-income housing.

To the extent that HOME does serve these goals, it works in combination with the local housing stock, developers' plans, and residents' preferences. Housing built by developers for sale tends to be located in high-poverty areas, probably much in need of revitalization,[14] while individual families buying homes in the private market with HOME assistance prefer to live in better communities than they previously lived in – areas with higher incomes, higher homeownership rates, and higher home values.[15] As they move, therefore, these families create more of a mixed-income neighborhood. By contrast, the developer-built housing is more likely to revive a poverty area, replacing poor housing or vacant lots with new affordable housing for homebuyers, and perhaps raise the neighborhood income level and alter the income mix.

HOME-assisted rental housing is less often located in high-poverty areas than is public housing, but more often than units occupied by Section 8 voucher holders. Rental rehabilitation is more concentrated in poor neighborhoods than either new construction projects or existing rental housing acquired by the local government. The rental rehab pattern should complement neighborhood revitalization efforts.

Community Development Block Grants. The Community Development Block Grant (CDBG) program, enacted in 1974 as the successor to urban renewal and half a dozen other categorical grants to local government, does have a neighborhood focus. Community revitalization figures explicitly in four of its nine objectives, and implicitly in several others. Better housing for low-income families is also an objective. CDBG contains low- and moderate-income targeting requirements, and expenditures have generally exceeded these requirements.[16]

Because it is a broad block grant, CDBG is hard to evaluate. Its impact is not easily measured, either by city or by neighborhood.[17] During its 30-year existence, CDBG has been combined with many other funding sources for community revitalization purposes. Nonetheless, it is possible to describe patterns of funding that are relevant. Cities have tended to concentrate some categories of expenditure in particular neighborhoods. This is particularly true of infrastructure spending; it is most concentrated in particular neighborhoods by those cities where poverty is most concentrated by neighborhood. That is, cities that most need community revitalization are using CDBG for that purpose. Concentration also occurs to a lesser extent for housing expenditures, although most cities pursue multiple housing strategies, some focused on particular neighborhoods, others citywide in scope.[18] Poor cities, and cities where poverty is concentrated by neighborhood (which are not the same thing), have been prone to use CDBG to engage in activities intended to revitalize some neighborhoods.

The Government Performance and Results Act has provided impetus for efforts to obtain better data on CDBG's neighborhood impacts. A recent study of 17 cities found that "larger CDBG investments are linked to improvements in neighborhood quality."[19] Improvements are measured in terms of residential mortgage lending and the number of businesses in the community, readily available information wh

The importance of neighborhood facilities and amenities is a major part of the rationale for CDBG, though CDBG does not provide operating funds for police or education, but rather for infrastructure.

This is not to advocate any particular policy in any particular city. The point is that, while there are many strategies to provide affordable and market-rate housing in urban communities, decent housing alone is not likely to be enough for city revitalization.

APPENDIX A: THE DISTRICT OF COLUMBIA FIRST-TIME HOMEBUYER INDIVIDUAL INCOME TAX CREDIT

In 1997 Congress enacted a federal income tax credit for first-time homebuyers, applicable only in Washington, D.C. The tax credit originally was set to expire on January 1, 2004, but was extended in 2004 as part of the Working Families Tax Relief Act of 2004, and now expires on January 1, 2006. It is the only federal tax provision providing help to first-time homebuyers in a particular city. Some states have enacted somewhat similar tax credits; a full review of state activity is beyond the scope of this paper, and the D.C. credit may be of particular interest because it is a federal program, as well as serving as an example.

The tax credit provides for a federal income tax saving up to $5,000 for low- and moderate-income families who have not owned a home within one year of purchasing the home for which they receive the tax credit. This is an unusually broad definition of "first-time homebuyer." More typical is at least a three-year nonownership requirement, or the common-sense concept of never having owned a home before. The income limit is $130,000 of Adjusted Gross Income for married couples filing jointly, and $90,000 for single individuals; the credit begins phasing out at $110,000 and $70,000, respectively. This also is a generous definition of low and moderate income. The national median household income has been between $40,000 and $45,000 over the period of the tax credit; the median income in the city of Washington was $40,100 in 1999 (the latest census data).

The most detailed published evaluation of the tax credit found that the credit was extensively used, with almost 22,000 households benefiting from it when they bought homes between 1997 and 2001. These households constituted about 77 percent of all District of Columbia homebuyers during the period. The average credit amounted to about $3,500. The generous targeting may not have been necessary to encourage homeownership; about 67 percent had never owned a home, while about 40 percent were in the middle-income range (between $30,000 and $50,000) and another 30 percent were somewhat above middle-income (between $50,000 and $75,000). This latter income category represents about the middle-income range for the entire metropolitan area; about 15 percent all D.C. homebuyers were families who received the credit and moved from the suburbs into the city. Unfortunately, the evaluation does not directly address the question of neighborhood impact; it does not report tax credit transactions by neighborhood. It does, however, conclude that the tax credit had a greater impact on house prices in low-income and high-minority neighborhoods (prices rose more in such neighborhoods from 1997 to 2001), which may imply that it was more widely used in these neighborhoods.[21] If this is a valid inference, than the tax credit may be helpful in revitalizing city neighborhoods.

The tax credit certainly may have contributed to the increase in homeownership within Washington mentioned above, but it was only available during the last two and a half years of the 1990s (between August 1997 and April 2000, the date of the decennial census), and some other large older cities experienced roughly similar increases during those 10 years without benefit of the credit.

Endnotes:

[1] U.S. Department of Housing and Urban Development, Office of Policy Development and Research. 1996. "Development and Analysis of the National Low-Income Housing Tax Credit Database."

[2] Cummings, Jean L., and Denise DiPasquale. 1999. "The Low-Income Housing Tax Credit: An Analysis of the First Ten Years." *Housing Policy Debate*, Vol. 10, No. 2, pp. 251-287, especially pp. 278-282.

[3] U.S. General Accounting Office. 1997. "Tax Credits: Opportunities to Improve Oversight of the Low Income Housing Program."

[4] Cummings and DiPasquale (1999) report that 10 percent of the projects in their database were built in census tracts with no new residential construction in the five years preceding, and 27 percent were in tracts with no new rental housing construction in the last five years. This of course implies that about two-thirds of projects were built in areas where other construction was occurring.

[5] The full list of "old big league cities" is: Boston, New York, Buffalo, Philadelphia, Pittsburgh, Baltimore, and Washington, D.C., in the Northeast; and Cleveland, Columbus, Cincinnati, Detroit, Indianapolis, Chicago, Milwaukee, St. Louis, Minneapolis, and St. Paul in the Midwest. Green Bay is excluded because of size.

[6] The Single-Family Affordable Housing Tax Credit is described at http://www.whitehouse.gov/infocus/homeownership.homeownership-policy-book-ch1.html.

[7] FHA does not track mortgages by municipality; I base this statement on a number of internal tabulations a(n)-4ID 17 B9(an0.002i2

Additional Readings and Expert Contacts

Low-Income Housing Tax Credit

Cummings, Jean L. and Denise DiPasquale. 1999. "The Low-Income Housing Tax Credit: An Analysis of the First Ten Years."

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