The Cost of Complexity in Low-Income Housing Assistance

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Introduction
Low-income housing assistance is fertile ground for reforms that would provide better outcomes for the money spent. Most current recipients are served by programs whose cost is enormously excessive for the housing provided. Phasing out these programs in favor of the system’s most cost-effective program would ultimately free up the resources to provide housing assistance to millions of additional people without any increase in taxes (Olsen 2014).

The current system of low-income housing assistance also provides enormous subsidies to some people while offering none to others who are equally poor, and it provides subsidies to many people who are not poor while offering none to many of the poorest. Avoiding these excessive subsidies and focusing assistance on the poorest families will contribute further to poverty alleviation (Olsen 2017).

Well-designed reforms of the current system of low-income housing assistance would not only alleviate poverty but also largely eliminate homelessness and evictions. These reforms would greatly simplify the system of low-income housing assistance by gradually replacing the current hodgepodge of programs with a simple program that offers housing assistance to all the poorest people.

Today most low-income housing assistance in the U.S. is delivered by subsidizing the construction, renovation, and operation of housing projects. The Low-Income Housing Tax Credit (LIHTC) is the largest and fastest growing program of this type. Since 1987, it has subsidized the construction of about 1.8 million units and the renovation of about 1.2 million. Over the program’s history, more than $200 billion in tax credits have been allocated, but its total cost to taxpayers has been much greater because tax credit projects receive subsidies from many other sources.

This complexity is totally unnecessary to achieve the purposes of low-income housing assistance, and it is one reason for the program’s excessive cost. Considerable resources are devoted to obtaining these subsidies and trying to enforce the restrictions associated with them, and the layering of subsidies from multiple sources leads to the building of expensive units. The per-unit development cost of LIHTC projects is about equal the median value of owner-occupied units in the same locality.

The simplest approach to providing housing assistance is to provide a subsidy to the people we want to help that is conditional on occupying housing meeting certain standards. HUD’s Housing Choice Voucher Program does that. This simple method can be used to subsidize homeowners as well as renters, and it can be combined easily with down-payment assistance to induce more recipients to be homeowners.

This is not only the simplest approach but also by far the most cost-effective (Olsen 2008, pp. 9-15). We do not need to build subsidized housing projects to solve a housing affordability problem. All people who spend a high fraction of their income on housing are housed. The least expensive way to reduce how much they spend on housing is to pay a part of their rent. The housing voucher program does that. Building new housing for these households and charging the same rent as they would pay under the voucher program is much more expensive.

Furthermore, it is neither necessary nor desirable to construct new units to house the homeless. The number of people who are homeless is far less than the number of vacant rental units—indeed, far less than the number of vacant units renting for less than the median. In the entire country, there are only about 600,000 homeless people on a single night and more than 3
million vacant units available for rent. Even if all homeless people were single, they could easily be accommodated in vacant existing units, and that would be much less expensive than building new units for them. The reason that they are homeless is that they do not have the money to pay the rent for existing vacant units. With some outreach and search assistance to the most troubled, a housing voucher would solve that problem. It would also prevent evictions for financial reasons. Housing vouchers are effective in preventing evictions because the subsidy is adjusted for the recipient’s income. If a voucher recipient loses income, the subsidy is increased.

The failure to offer housing assistance to many of the poorest households is one of the two major defects of the current system of low income housing assistance, and the path to remedying this defect at a reasonable cost to taxpayers is to phase out cost-ineffective programs in favor of the cost-effective housing voucher program. Olsen (2008, pp. 17-23; 2017, pp. 95-102) describes steps that would provide a smooth transition to a system that would offer housing assistance to all the poorest households.

In this written testimony, I document the complexity of the tax credit program, provide information about the nature, prevalence, and magnitudes of its many subsidies, compare the performance of the tax credit and housing voucher programs, analyze several common arguments for subsidizing the construction of housing projects, outline major reforms that would lead to an efficient and equitable program of housing assistance, and describe a modest proposal that would reduce homelessness and evictions without additional government spending.

Low-Income Housing Tax Credit Program

Under LIHTC, the federal government authorizes state housing agencies to allocate a specified amount of nonrefundable tax credits to selected developers to build or renovate housing projects for low- and moderate-income households. Some federal tax credits are awarded through a competitive process; others are automatically awarded to developers who are allocated state private activity bonds to help fund their projects. Because interest on these bonds is not subject to federal income taxation, they provide financing at a below-market interest rate.

The tax credit subsidies are substantial. For projects not funded with tax-exempt bonds, states can award tax credits whose present value can exceed 100% of the construction or rehabilitation cost in some cases. For projects funded with tax-exempt bonds, they can award tax credits whose present value is up to 39% of the construction or rehab cost.

Since tax credits are nonrefundable and developers rarely, if ever, have sufficient tax liabilities to use most of their tax credits, almost all are sold, mainly to large financial institutions with substantial tax liabilities and CRA requirements. Syndicators often play a role in arranging these transactions and protecting the interests of those who buy the tax credits.

In return for these subsidies, developers agree to provide housing meeting certain minimum standards for rents less than certain amounts to households with incomes less than certain limits for at least 30 years. For a four-person family, the limit is almost always 60% of area median income. The limit is smaller for smaller families and larger for larger families. The

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2 https://fred.stlouisfed.org/series/ERENTUSQ176N
2 The four-person limit is based on the local median income for families of all sizes. The income limits for families of other sizes are obtained by multiplying the four-person limit by a nationally uniform constant. For example, this constant is 0.7 for a single person and 1.16 for a family of six. Developers may choose income limits based on 50% or 60% of the local median. If they choose 50%, they must commit at least 20% of their units to the tax credit program. If they choose 60%, they must commit at least 40% to the program. Since tax credit development is more profitable than unsubsidized development and the 60% option enables the developer to charge higher rents and
Income limits for families of various sizes are converted to income limits for units with each number of bedrooms, and the rent ceilings are 30% of the relevant income limit. These rent ceilings are roughly local median rents. Unlike other major low-income housing programs, the tenant’s rent does not depend on the tenant’s income unless the project receives a subsidy from another program that requires it. Tenants without such a subsidy will pay more than 30% of their income in rent.

The number usually reported as the program’s cost to taxpayers in a year is the competitive allocation for additional projects in that year. In 2016, this was about $7.8 billion. Total public expenditure on tax credit projects is much greater. The most obvious omission is noncompetitive tax credits that are associated with tax-exempt bond financing. In 2016, about $3.2 billion in noncompetitive credits were allocated. Therefore, accounting for noncompetitive tax credits alone increases the usually reported public subsidy more than 40%.

This simple description greatly understates LIHTC’s complexity and the cost of delivering housing assistance in tax credit projects. Few tax credit projects receive only tax credit subsidies. NCSHA (2018, Table 8) lists 18 other federal sources that provide subsidies to some tax credit projects and an all-other category that includes a hodgepodge of smaller federal sources. In 2016, more than 91% of all tax credit units received subsidies from at least one of these sources. This list of subsidy sources does not include the tenant-based Housing Choice Voucher Program that provides subsidies on behalf of about 10% of all tenants. It also does not include ubiquitous subsidies from local and state governments. Based on data for projects approved in California between 2009 and 2016, 90% of projects have at least 2 other development funding sources beyond a conventional first mortgage and tax credits, two-thirds have at least 3, and more than a fifth have at least 5.

Assembling subsidies from many sources and attempting to enforce their restrictions has a substantial cost. This requires many talented workers doing jobs that are not necessary to deliver housing assistance efficiently. The result is that the development cost of a typical tax credit unit is about equal to the average market value of owner-occupied homes in the same locality.

The primary types of subsidies to developers beyond the tax credits themselves are rental assistance payments, subsidized loans, land at below-market prices, property tax abatements and exemptions, and state tax credits. I’ll document their nature, prevalence, and magnitude to the extent possible.

Rental Assistance
The owners of many tax credit projects receive rental assistance each month on behalf of some or all tenants. Many projects have involved rehabilitation of older HUD- and USDA-subsidized projects, and these programs continue to provide subsidies on behalf of their tenants to the tax credit redevelopers. In addition, some new-construction projects have received project-based housing vouchers from public housing authorities to house families from the authority’s voucher waiting list. Finally, about 10% of tax credit units are occupied by families with tenant-based Section 8 Housing Choice Vouchers. These tenants have chosen to use their vouchers in tax credit projects. Because the ceiling rent in the tax credit program applies to the tenant’s rent, the sum of the tenant’s rent and voucher subsidy can exceed the ceiling. Therefore, housing a family with a tenant-based voucher provides extra revenue to the owner without extra cost.

Increases the number of households that can live in the project, almost all developers choose the 60% option and commit all of the units not occupied by a manager or other staff to the tax credit program.
Developers receive substantial rental assistance payments on behalf of these tenants. According to HUD’s non-public-use LIHTC data set, owners of tax credit projects received rental assistance payments on behalf of about 42% of their tenants in 2015 and the mean payment on behalf of these households was $611 a month. Therefore, the owners of tax credit projects received about $9.2 billion in rental assistance payments in 2015. This is roughly the magnitude of the tax credits claimed in that year.

Subsidized Loans
Almost all tax credit projects are developed with the help of subsidized loans. Many have multiple loans of this type. In most cases, the ultimate source of the subsidy is the federal treasury. However, many projects also have subsidized loans partially funded from local government tax revenue.

The largest federally funded programs that provide subsidized loans are the Treasury’s multifamily housing bonds (MHB) and HUD’s HOME intergovernmental housing block grant program. For new allocations in 2016, multifamily housing bonds funded a part of the development cost of tax credit projects that accounted for about 42% of all units (NCSHA 2018, Table 8). Because the interest on these private activity bonds is not taxable under the federal income tax, they pay lower interest rates and have a cost to the federal treasury. The HOME Program provided subsidized loans on behalf of about 13% of tax credit units. Many other federal programs such as USDA’s Section 515 program provide subsidized loans in support of fewer units.

Local governments also provide loans to tax credit developers at below-market interest rates from their own resources. Because localities often raise the money to make these loans by issuing bonds and the interest on these bonds is exempt from federal taxes, a federal subsidy is involved. However, the subsidy goes beyond that. The loans are often residual or deferred loans. Residual loans are repaid each period only to the extent permitted by positive cash flow (that is, revenues greater than operating expenses and first mortgage debt service). If a project’s cash flow is negative, no payments are made on its residual loans. If cash flow is positive, only some may be repaid. Deferred loans are loans that have no payments due for some years, at least thirty in most cases. The extent of the subsidy borne by local taxpayers depends on the extent to which these loans are repaid.

National data on the prevalence of residual and deferred loans is not publicly available. For tax credit projects approved in California between 2009 and 2016, they were common. About 39% of the projects had at least one residual loan and about 25% had at least two. About 22% had at least one deferred loan. About 43% of tax credit projects had at least one residual or deferred loan, about a third had two or more, and about a fifth had at least three.

In the California projects, residual loans were not only common but also substantial. Among the projects that had residual loans, the mean amount of these loans is about $5 million. The mean development cost of these projects was about $22 million. In total, residual and deferred loans paid for about 7% of the development cost of all projects approved in California during this period.

A key question is the extent to which residual and deferred loans are repaid. If they are not repaid at all, they are, in effect, grants. Although syndicators, developers, and others in the business know the extent to which their projects have repaid residual loans, this is not public information. In a major study based on the data of four large syndicators who accounted for

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3 Thanks to Mike Hollar in HUD’s Office of Policy Development and Research for providing these numbers.
about a fourth of tax credit projects in the program’s first ten years, Cummings and Di Pasquale (1999, p. 253) report that about 22% of the projects had negative cash flow and hence paid nothing on their residual loans. Presumably, other projects with small cash flow had too little to pay the entire amount due. Little information about the repayment of deferred loans is available because few have become due. They are almost always for at least 30 years, and the program has existed for only 33 years.

Cummings and Di Pasquale made a conservative estimate of the dollar amount of the subsidy associated with all loans at below-market interest rates based on the assumption that the market interest on these loans would be the interest rate on thirty-year constant maturity Treasury bonds. Because the risk of default on these bonds is negligible, this interest rate clearly understates the market rate on the subsidized loans that funded the development of tax credit projects, especially residual and deferred loans. Cummings and Di Pasquale concluded that grants and loans at below-market interest rates provided subsidies equal to at least 50% of the tax credits. If Cummings and DiPasquale’s result applied to the current situation, these subsidies would add at least $5.5 billion to total public expenditure on tax credit projects.

When the noncompetitive tax credits, rental assistance, and government loans at below-market interest rates are added to the usually cited competitive tax credits, the total annual subsidy exceeds $25 billion. But this is not the end of the story. Local governments and public housing authorities provide substantial additional subsidies in the form of land at below-market prices and local property tax abatements, and some states supplement federal with state tax credits. Although national data on the extent and magnitudes of these subsidies are not available, I will provide some fragmentary information.

**Land at Below-Market Prices**

Some tax credit projects are built on land gotten from a local government or public housing authority for a nominal amount. A recent GAO report on tax credit development cost in ten states and two large cities revealed that the median land cost for the 157 LIHTC projects undertaken in New York City over the period of their study was $1 (GAO, 2018, Table 4, p. 86). About 10% of the projects approved in California between 2009 and 2016 bought or leased their land from a local government and a similar percentage bought or leased it from a public housing authority. In about 8% of all projects, the price was clearly well below market, usually $1 or $1 per year.

The GAO report and the California data do not indicate the market value of this land. However, in the California data, the median value of the land and its existing structures (if any) that was not sold or leased for a nominal amount was about $3.8 million and the median value of land without existing structures was about $1.9 million. The means were even greater -- $7.3 million and $2.9 million. Therefore, even if the prices charged by local governments and housing authorities were more than nominal, say $100,000, they could still involve substantial subsidies.

In some cases, local governments and public housing authorities might sell or lease land at a market price but deliver a subsidy by providing a residual loan that is not repaid to any significant extent. Giving a developer land for free or a nominal amount would raise a fuss in some places. A residual loan is less likely to raise objections, and the failure to pay debt service on the loan is unlikely to be noticed by the public.

**Tax abatements and exemptions**

Some, possibly many, tax credit projects receive property tax abatements. The results of the annual National Apartment Association (NAA) survey of operating income and expenses suggest
the magnitude of this subsidy. In unsubsidized projects, the annual tax payment in 2017 was $1,741 per unit. In subsidized projects, it was $881 per unit. Most privately owned subsidized projects are tax credit projects. Although the difference in property taxes could simply reflect differences in the desirability of the units and hence their market values, the units were of about the same average size (931 and 899 sq. ft.) and had about the same overall operating expenses ($5,369 and $5,375). A report by Enterprise Community Partners about their substantial portfolio of tax credit units indicates annual property taxes of $359 per unit in 2015. In California, all tax credit projects with a not-for-profit sponsor are exempt from local property taxes. Not surprisingly, virtually all for-profit developers find a not-for-profit organization to cosponsor their developments.

State tax credits
Finally, eighteen states provide low-income housing tax credits that must or can be combined with federal tax credits (NCSHA 2018, Table 16). In California, about 14% of all projects with federal tax credits also receive state credits. These credits are substantial for the projects that get them – a third as large as their federal credits.

LIHTC’s Per-Unit Development Cost
A wide variety of sources provide subsidies to tax credit projects, and almost all projects receive subsidies from multiple sources. The layering of subsidies from multiple sources enables the building of expensive units.

To put the development cost of tax credit projects into perspective, Table 1 compares the per-unit development cost of tax credit projects in ten representative states from a recent GAO study with the median value of owner-occupied units in these states for the same time period. These numbers somewhat understate the true development cost of the tax credit projects because some projects are built on land bought or leased at a below-market price from a local government or public housing authority. The simple average of the development costs across the ten states was slightly less than $200,000 per unit. The simple average of the median value of owner-occupied units across the ten states was about $214,000.

To get results at a lower level of geography, I compared the per-unit development cost of the 47 projects featured in a journal called Affordable Housing Finance from October 2017 through March 2018 with the median value of owner-occupied units in the same locality. Their means were virtually identical -- $293,000 v. $290,000.

Revelations in the popular press about the enormous per-unit development cost of some LIHTC projects has led to congressional concern about this matter. For example, a segment on the PBS News Hour in 2013 revealed that about $500,000 per apartment had been spent to build a housing project for the homeless in San Francisco. While not the norm, extremely large amounts are not uncommon. About a third of the projects approved in California between 2009 and 2016 had development costs in excess of $400,000 per unit, 13% had development costs greater than $600,000 per unit, and 3% had development costs over $1,000,000 per unit. Housing is expensive in California. The median value of owner-occupied units there was about $385,000 in 2015 compared with a national median of $196,600. But these development costs are high even by its standards.

I conclude that we are spending enough on LIHTC developments to provide occupants of
tax credit units with housing as good as the housing occupied by the average homeowner. Since
the income of the average homeowner exceeds the average income of all households by more
than 20%, this raises the obvious question as to whether we should spend this much on the
housing of some low- and moderate-income households when we are failing to offer any housing
assistance to three fourths of the poorest households.

**Simpler Is Better**

HUD’s Housing Choice Voucher Program is much simpler than LIHTC. When an eligible family
reaches the top of the voucher waiting list, it is told what subsidy it will receive to help pay for
its housing and invited to search for a unit that meets the program’s housing standards and whose
landlord is willing to participate in it. In many cases, the family’s current unit meets the
standards, its landlord is willing to participate, the tenant stays in the unit at least for a while, and
the program pays a part of the rent. In other cases, the tenant must find another unit in order to
participate or chooses to do it to occupy a better unit immediately.

The voucher program is not only simpler than LIHTC, but its performance is better. For
starters, the voucher program is much better targeted on the poorest households. Only 44% of the
households in LIHTC projects have extremely low incomes compared with about 73% in the
voucher program. Most households with extremely low incomes in tax credit projects receive
deep subsidies from HUD programs.

The voucher program is also far the most cost-effective low-income housing program.
We have excellent evidence on its cost-effectiveness compared with older programs that
subsidized the building and operation of housing projects. The best study of HUD’s largest
program that subsidized the construction of privately owned projects indicated the total cost of
providing housing under this program was at least 44 percent greater than the total cost of
providing equally good housing under the housing voucher program (Wallace and others 1981).
This translated into an excess taxpayer cost of at least 72 percent for the same outcome. The best
study of HUD’s second largest program of this type produced similar results (Mayo and others
1980). Public housing has even larger excess cost (Mayo and others 1980).

Despite the enormous public expenditure over its history, we don’t have a cost-
effectiveness study of this quality for the tax credit program. A 2001 GAO study indicated that
tax credit projects that involved the building of new units cost 16% more than housing vouchers
to provide units with the same number of bedrooms in the same metro area. This is clearly an
underestimate of the cost difference because it omitted some of the subsidies to developers of tax
credit projects, namely, rental assistance payments from the Housing Choice Voucher Program,
land from local governments at below-market prices, and local property tax abatements, and it is
based on a conservative estimate of the subsidy associated with loans at below-market interest
rates to tax credit developers (especially soft loans). The programs are equally effective in the
sense that they provide housing meeting certain minimum standards, but unlike the studies of
older programs, the GAO study did not consider whether tax credit units are better or worse than
voucher units over the 30 years of the use agreement.

One consequence of LIHTC’s excess cost is that occupants of tax credit projects capture

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6 About 16% of households have extremely low incomes on HUD’s definition. For 4-person households, they are
households with incomes less than 30% of the local median. Nationally uniform adjustments are used to get income
limits for larger and smaller households. The results reported are for 2017 from HUD (2019, Table 9) and HUD’s
a small fraction of the subsidies provided to developers on their behalf. Combining evidence from Greg Burge’s 2011 study of LIHTC projects in Tallahassee with evidence from Cummings and DiPasquale’s study of the importance of grants and loans at below-market interest rates leads to the conclusion that the present value of the rent saving to tenants (the difference between the market rent of the unit and the rent paid by its tenant) is less than 37% of the present value of the subsidies to tax credit developers. In contrast, the best studies indicate that market rents are paid for voucher units and hence voucher recipients capture all the subsidy paid to the landlord (Olsen 2019). The tenant’s rent is below the market rent by the amount of the subsidy.

What accounts for the large differences in the total cost of providing equally good housing under programs of tenant-based and project-based assistance? Although evidence about the relative importance of various factors does not exist and the relative importance will differ for different programs, the plausible explanations are the absence of a financial incentive for good decisions on the part of civil servants who operate public housing, the excessive profits that inevitably result from allocating subsidies to selected developers of private subsidized projects, the resources that developers devote to securing the subsidies, and the distortions in usage of inputs resulting from the subsidy formulas. A special case of the latter is that project-based assistance is usually tied to the construction of new units. The least expensive approach to improving the housing conditions of low-income households involves heavy reliance on upgrading the existing housing stock, the primary mechanism through which tenant-based assistance achieves this goal.

A PBS Frontline documentary called Poverty, Politics, and Profit reveals another reason for LIHTC’s excess cost, namely, fraud. A follow-up piece with NPR, Department of Justice news releases, and articles in the Miami Herald provide more details. One investigation of several developers revealed excess subsidies of $36 million for 14 projects. Because subsidies are proportional to development cost, developers have an incentive to overstate them. In the fraud uncovered in this investigation, the developer who was awarded tax credits persuaded contractors to provide inflated invoices for their work on the projects combined with kickbacks to the developers. Due to the difficulty of determining true development cost, this unscrupulous developer succeeded in greatly overstating them. To give a sense of the magnitudes involved, the PBS documentary indicated that the developer of one project overstated its development cost by about 17%. Recent investigations have uncovered similar fraud in Los Angeles, New York City, Dallas, and Maine, and other investigations are underway. Because the fraud involved is difficult to detect, the few cases uncovered so far are surely the tip of the iceberg. More than 40,000 projects have been built.

The results concerning the cost-effectiveness of different housing programs illustrate the

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8 https://www.npr.org/2017/05/09/527046451/affordable-housing-program-costs-more-shelters-less,
virtue of forcing sellers to compete for the business of buyers. Under a program of tenant-based assistance, suppliers cannot charge much more than market rents for their units for long because the tenant could move to a better unit without paying more for it. The subsidy is portable. Under programs of project-based assistance, suppliers who receive payments greater than market rents for their housing can remain in the program indefinitely because their tenants would lose their subsidies if they moved. These suppliers have a captive audience.

A simple example illustrates these general points. Suppose that the housing voucher program agreed to pay $1,200 a month for a unit that would rent for only $800 in the unsubsidized market. Suppose that the voucher recipient paid a rent of $400 a month based on its household income. The government pays the difference -- $800 a month. Units that have a market rent of $1,200 a month are much more desirable than units with a market rent of $800 a month in the same locality. Therefore, this voucher recipient would benefit substantially from moving to a unit with a market rent of $1,200 a month. Under the housing voucher program, they could make this move without any change in their rent. Before the move, the rent saving to the tenant $400 (= $800-$400) is only half of the government subsidy. After the move, the rent saving to the tenant $800 (= $1200-$400) is equal to the government subsidy. The tenant captures all the subsidy. In the same initial situation, the occupant of a subsidized housing project would not have any incentive to move. Suppose that the tenant’s rent in the subsidized project is $400 a month, the government provides the owner with a subsidy of $800 a month, and the owner provides a housing unit that would rent on the unsubsidized market for only $800 a month. As before, the rent saving to the tenant $400 (= $800-$400) is only half of the government subsidy. However, the rent saving is substantial, and the tenant would lose it if he or she moved. This tenant would stay put, and the owner could capture half of the subsidy in perpetuity.

Arguments for Subsidizing the Construction of Housing Projects
Although cost-effectiveness and recipient choice make a strong case for exclusive reliance on tenant-based assistance, some argue for subsidizing the construction of housing projects. I’ll address the most common arguments.

Some argue that we must subsidize the construction of housing projects to deal with a shortage of affordable housing. This ignores the simple truth that existing units can be made affordable to their occupants by paying a part of the rent, and this is much less expensive than building new units and charging the tenants the same rents that they would pay in their existing units.

Others argue that we need to subsidize the construction of housing projects to deal with an overall shortage of housing (that is, a low vacancy rate). This fails to appreciate how suppliers in unsubsidized housing markets respond to low vacancy rates. When vacancy rates are unusually low, rents will be unusually high. This is when unsubsidized construction will be most profitable, and as a result, the construction of new units will accelerate. This will lead to a higher vacancy rate and a lower rate of increase in rents. The unsubsidized market is a self-correcting mechanism in this regard. In the unsubsidized market, new units will rarely be built for low-income households. However, when middle income families move into new units, the existing units vacated by these families will become available to lower income households (Rosenthal 2014). We don’t need subsidized construction to deal with low vacancy rates.

Some people seem to believe that each unit built under a subsidized construction program adds one unit to the housing stock. This is far from the truth. The credible evidence about LIHTC indicates almost complete crowd out. The best of these studies is Eriksen and Rosenthal’s 2010
paper. Their conclusion is that nearly 100% of LIHTC development is offset by a reduction in
the number of newly built unsubsidized rental units. More units are built in some locations and
fewer in others. However, the net increase in the housing stock is minimal. Malpezzi and Vandell
(2002) and Baum-Snow and Marion (2007) have produced similar results, albeit not as precisely
estimated.

These results undercut a common argument for subsidized construction programs,

namely, that the programs increase employment. The evidence offered in support of this

argument is simply the number of workers involved in building and renovating projects. The

preceding evidence indicates that in the absence of LIHTC these workers would have been

involved in building or renovating unsubsidized units.

Another common belief is that tenant-based housing vouchers have no effect on the

number of dwelling units in existence or a much smaller effect than subsidized construction

programs. The only available evidence indicates the opposite (Sinai and Waldfogel 2005). This

surprising result has a plausible explanation. When people who are doubled up are offered

housing assistance of any sort, they move into their own unit. The poorest people are doubled up
to a greater extent than people with somewhat higher incomes. The housing voucher program
serves the poorest people to a greater extent than the aggregate of all subsidized construction

programs studied and especially LIHTC (O’Regan and Horn 2013, Table 2).

Advocates for subsidizing the construction of housing projects often concede that

housing vouchers will work well in markets with high vacancy rates but argue that we need to

subsidize the construction of housing projects in order to serve low-income households in

markets with low vacancy rates. On this argument, the construction of tax credit projects should

be concentrated in areas with low vacancy rates.

Table 2 indicates that this is not the reality of the tax credit program. The table is based

on annual data on the number of tax credit units placed in service and the rental vacancy rate in
the 75 largest metro areas over ten years. It shows the number of tax units placed in service in each
range of vacancy rates and the number of these units relative to the number of occupied
rental units in the metro area. On average, tax credit units placed in service were about a fourth of
a percent of the occupied rental stock each year. Importantly, this percentage was about the
same in the tightest and loosest markets. Over the decade, most tax credit units were built in
metro areas with vacancy rates in excess of 8%. Almost 40% were built in metro areas with
vacancy rates in excess of 10%. To put these numbers in perspective, the mean rental vacancy
rate in the U.S. over the past 60 years has been 7.4%.

Finally, many argue that tenant-based assistance will not work well in markets with the
lowest vacancy rates because these markets do not have enough affordable vacant apartments
that meet minimum housing standards to house all families who are offered vouchers. In fact, it
is not necessary for the number of vacant apartments that meet minimum housing standards and
are affordable to voucher recipients to exceed the number of new and recycled vouchers
available in order to use all vouchers available. Many families offered vouchers already occupy
apartments meeting the program’s standards. We do not need vacant apartments for these
families. They can participate without moving. Other families who are offered vouchers live in
housing that does not meet Section 8 standards. However, these apartments can be repaired to
meet the standards. Similarly, vacant apartments that do not initially meet the program’s
standards can be upgraded to meet them. About half of the units in the voucher program were
improved by their landlords to meet the program’s minimum standards. In short, a tenant-based
voucher program leads to an increase in the supply of apartments meeting minimum housing
standards. Olsen (2008, pp. 31-33) summarizes the evidence about these matters.

In short, none of the arguments for subsidizing the construction of housing projects withstands scrutiny.

**Fundamental Reform**

If Congress wants to serve the interests of low-income families and the taxpayers who want to help them, it should shift the budget for low-income housing assistance from project-based to tenant-based housing assistance as soon as current contractual commitments permit and should not authorize additional spending on the construction of housing projects. This would increase the cost-effectiveness of the system, and replacing the current system of low-income housing assistance with a tenure-neutral housing voucher program that offers the same assistance to all eligible families in the same circumstances would eliminate its inequities and bias against homeownership. It would also largely eliminate homelessness and evictions.

In a paper for the Brookings Institution’s Hamilton Project, I have described specific reforms of the current system that would gradually lead to this outcome (Olsen 2008, pp. 17-23). They deal with all parts of the system – active construction programs, existing privately owned housing projects, public housing, and the housing voucher program. These reforms would not hurt current recipients. Indeed, they are designed to benefit many of them. For example, public housing tenants would be offered a choice between housing vouchers and staying in their current units on the same terms. Current recipients of Section 8 vouchers could be allowed to receive the generous subsidies that are now offered by the program while new recipients receive less generous subsidies so that more households can be served. The proposed reforms honor legal commitments. For example, payments on current terms will be provided to owners of private subsidized projects until the end of their use agreements. After the transition is complete, millions of additional families would receive housing assistance that enables them to occupy better housing in nicer neighborhoods and have more to spend on other goods. Millions of other families that would have received project-based assistance with the continuation of the current system would live in housing and neighborhoods that they prefer to their units in subsidized projects.

To illustrate the magnitude of the gains that would ultimately flow from the reforms and allay concerns about their effects on various subgroups, I have estimated the effects on the number of families served of phasing out the bulk of HUD’s programs in favor of alternative housing voucher programs that offer assistance to all of the poorest households (Olsen 2014). Most have about the same taxpayer cost as the current programs, but one spends about 10 percent less. The results of the analysis are striking. They indicate that even the reformed program that reduces public expenditure by more than 10 percent would serve 75 percent more people in total and many more in families of each type – white, black, and Hispanic; elderly and nonelderly; families living in metropolitan and nonmetropolitan areas; small, medium, and large families; and families in the first two real income deciles. The most underserved types experience the largest increases.

**A Modest Proposal**

Fundamental reforms of the current system of low-income housing assistance to serve the interests of the poorest members of the community and the taxpayers who want to help them with their housing will be politically challenging because many people have a vested interest in
the continuation and expansion of the current system. State housing agencies are thrilled to receive substantial tax credits each year to distribute at their discretion to selected developers. HUD and USDA are delighted to have money that isn’t in their budget used to fund renovation of their housing projects. The people who own and manage these old subsidized projects are elated to be able to offer better units that need less maintenance. This reduces their cost and leads to fewer tenant complaints. LIHTC’s continuation and expansion benefit the developers, syndicators, lawyers, accountants, market analysts, and others who have devoted the time to master its complexities. Developers earn higher profits than in unsubsidized construction, and others are well paid for their expertise. Given the program’s complexity, it makes financial sense for the developer to use these specialized resources. However, the complexities themselves lead to greatly excessive cost for the housing provided. Equally good housing could be provided to the tenants of tax credit projects at a much lower total cost (that is, cost to tenants and governments) using housing vouchers. This would enable us to serve many additional people with the same expenditure.

Given the daunting political obstacles to more fundamental reform, I’ll suggest a modest reform of the housing voucher program that will reduce homelessness and evictions without greater public spending. HUD’s Housing Choice Voucher Program provides very large subsidies to its recipients while offering nothing to other families in similar economic circumstances. Providing smaller subsidies to more households would almost surely reduce homelessness and evictions.

In 2019, the national mean voucher subsidy for a household with one adult, two children, and no countable income was almost $1,200 a month. In expensive places, it is much higher – about $2,000 a month in New York City and Los Angeles. Current voucher subsidies enable their recipients to occupy rental units of about average desirability without devoting more than 30% of their income to their housing. Subsidies of this magnitude are not necessary to prevent homelessness and evictions. It is possible to occupy and retain more modest units with smaller subsidies.

Homelessness and evictions can be reduced without spending more money or harming current voucher recipients by offering new recipients less generous subsidies, authorizing enough additional vouchers so that the same amount is spent on the program, and allowing current recipients to retain their current subsidies until they leave the program. Because a significant number of voucher recipients exit the program each year (about 10%), this initiative will allow many more families to be served each year without spending more money. Eventually, all participants in the same economic circumstances would receive the same lower subsidy, but many more households would be served.

Although some question it, there is little doubt that less generous vouchers could be used. At current subsidy levels, many more people want to participate than can be served with the existing budget. Waiting lists are long and usually closed to new applicants. When they are briefly opened for new applications, riots to get on them have occurred. A modest reduction in their generosity would not eliminate the excess demand. Reducing the voucher subsidy by the same amount for households at all income levels would make families currently eligible for subsidies less than this amount ineligible for voucher assistance. These are the currently eligible households with the largest incomes. This would free up money to provide vouchers to needier households that would not have been served by the current system.

Vouchers much less generous that regular Section 8 vouchers have been used throughout the country to provide time-limited housing assistance to the homeless. In HUD’s Family
Options Study, the average monthly cost of community-based rapid rehousing (CBRR) vouchers was $880 ($634 for the housing and $246 for search assistance). The average monthly cost of regular Section 8 vouchers was $1,172 (all for the housing). Therefore, the CBRR vouchers in the study provided housing vouchers about half as expensive as regular Section 8 vouchers and had an overall cost about 25% less (Gubits and others 2016, p. 111).

Although the Family Options Study did not test this option, it is reasonable to believe that offering modest housing vouchers without time limits to all the poorest people would largely eliminate homelessness and evictions. It would provide the biggest bang for the buck in this regard.

**Conclusion**

It is easy to understand why people and organizations involved in the development and operation of tax credit projects support it. However, if we want to offer housing assistance to all of the poorest households at a reasonable cost and thereby end homelessness and evictions, we must use an approach that is better targeted on the poorest and delivers much more housing for the money. The housing voucher program is that approach. As long as we continue to fund the construction of expensive housing projects rather than expand the housing voucher program, the majority of the poorest households will not receive any housing assistance. Instead they will cycle through evictions, temporary sharing of crowded housing, and homelessness.
References


https://virginia.app.box.com/s/7w5zmypmh44ljg5z6jba0qaod4pswax
<table>
<thead>
<tr>
<th>State</th>
<th>LIHTC Development Cost Per Unit (dollars)</th>
<th>Median Value Owner-Occupied Units (dollars)</th>
<th>Ratio of Per-Unit Development Cost to Median House Value</th>
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</thead>
<tbody>
<tr>
<td>Arizona</td>
<td>188,400</td>
<td>167,500</td>
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<td>California</td>
<td>307,107</td>
<td>385,500</td>
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<td>141,126</td>
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<td>Washington</td>
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<tr>
<td>Mean</td>
<td>197,733</td>
<td>213,500</td>
<td>0.93</td>
</tr>
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Sources: GAO (2018, Table 4); data.census.gov, 2015 ACS, 5-year estimates
Table 2

Number of Tax Credit Units Built in Metro Areas with Different Vacancy Rates
75 largest metro areas, 2005-2014

<table>
<thead>
<tr>
<th>Vacancy Rate (%)</th>
<th>Tax Credit Units Placed in Service</th>
<th>Tax Credit Units as % of Occupied Rental Units</th>
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<tr>
<td>2.0-3.9</td>
<td>13,931</td>
<td>0.24</td>
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<tr>
<td>4.0-5.9</td>
<td>117,729</td>
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<td>6.0-7.9</td>
<td>145,076</td>
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<tr>
<td>8.0-9.9</td>
<td>84,894</td>
<td>0.21</td>
</tr>
<tr>
<td>10.0-</td>
<td>223,220</td>
<td>0.25</td>
</tr>
<tr>
<td>Total</td>
<td>584,850</td>
<td>0.24</td>
</tr>
</tbody>
</table>

Note: Each observation refers to a single metro area in one year.
Sources: Vacancy rates, [https://www.census.gov/housing/hvs/data/ann15ind.html](https://www.census.gov/housing/hvs/data/ann15ind.html)
Tax credit units placed in service, [https://www.huduser.gov/portal/datasets/lihtc.html](https://www.huduser.gov/portal/datasets/lihtc.html)
Occupied rental units, [http://factfinder.census.gov/faces/nav/jsf/pages/index.xhtml](http://factfinder.census.gov/faces/nav/jsf/pages/index.xhtml)