THE CENTER FOR INDIAN COUNTRY DEVELOPMENT

Low Income Housing Tax Credits and Affordable Rentals in Indian Country

CSWEP Summer 2019 Economics Fellow
Kenneth Whaley

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In this article, I assess the scope of the Low Income Housing Tax Credit (LIHTC) program and how this major affordable rental housing construction subsidy has reached Indian Country and other tribal statistical areas. To frame this discussion, I first provide a qualitative overview of program details and efforts to incentivize development in tribal areas.[1] Then, using publicly available data on the locations and characteristics of rental units built under this program,[2] I describe supply trends in LIHTC projects in tribal areas relative to other locations in the United States over time. The goal of this article is to provide insight into how the complex relationship between economic incentives and policy objectives creates a unique challenge for LIHTC development in tribal areas.

LIHTC Background and Reaching Indian Country

Created as part of the Tax Reform Act of 1986 and overseen by the U.S. Internal Revenue Service, the federal LIHTC program is designed to increase the supply of affordable rental housing nationally by incentivizing development in high-need areas through the distribution of tax credits. The basic process requires housing developers to propose LIHTC projects to state housing agencies charged with allocating federal tax credits. The application process is competitive and intensive, and it is not uncommon for developers to apply more than once before their projects are approved. The amount of tax credits awarded to selected developers is based on total construction costs. The tax credits are then sold to capital investors on a secondary market.[3]

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* Kenneth Whaley is a Ph.D. candidate in economics at Clemson University. Email: kdwhale@g.clemson.edu.
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[1] Freddie Mac and the U.S. Department of Housing and Urban Development publish annual white papers describing LIHTC in Indian Areas. Discussions with subject matter experts at the Urban Institute, Travois, and Big Water Consulting have also contributed to this article.

[2] www.huduser.gov/portal/datasets/lihtc.html.

[3] The Urban Institute surveyed several investment firms and estimates the average price reached a low of $0.60 during the recession and peaked in 2016 at $1.06 per $1.00 of tax credits. These findings are from a 2018 report, *The Low-Income Housing Tax Credit: Past Achievements, Future Challenges*, which is available at www.urban.org/research/publication/low-income-housing-tax-credit-past-achievements-future-challenges.

Investors benefit by having their annual tax liability reduced by the face value of the credits spread over a 10-year period following construction.[4] While not required, program incentives tend to result in the majority of projects having 90 percent or more of units leased at below-market rent.

To reach Indian Country, states can create additional incentives in the selection process. Each year, states release a qualified action plan with guidelines describing the scoring and ranking system for new projects. In states with a significant Indian Country population, these guidelines will assign either an explicit priority or larger credits to projects that serve tribal areas. For example, Arizona sets aside $2 million annually in credits specifically for proposals in tribal areas, and California sets aside $1 million. Reservation-based development in North Dakota is eligible for up to 30 percent higher credits than non-reservation counterparts, and South Dakota adds points during the selection process for projects in tribal areas. In the Pacific Northwest, Oregon leads in the number of LIHTC properties in tribal areas and recently introduced new incentives for LIHTC development specifically targeting tribal areas.

Other underserved areas are similarly prioritized during project review and selection. These underserved areas compete with tribal lands for priority in the state selection process. Thus, while state-specific priorities are useful in making projects in tribal lands more competitive applications, the ultimate impact on total investment levels is less clear. Previous research has attempted to establish the general effect of qualified action plan incentives on the location of LIHTC production, albeit specifically focusing on incentives for construction in impoverished urban areas and the effect on long-run poverty rates.

Ellen et al. (2015) studied these state-specific priorities and found that new location-based incentives in qualified action plans are correlated with increases in LIHTC activity. They stopped short, however, of finding that the increases are caused by changes in the action plans. This point is of particular interest for Indian Country if the primary goal of state-specific LIHTC priorities is to increase the number of affordable rental housing projects in tribal areas. The idiosyncratic nature of qualified action plans makes it difficult to assess how well these state-specific priorities actually work to achieve their objectives in underserved areas. Further research is needed to understand the specific implications for using LIHTC incentives in Indian Country to expand opportunities for affordable rental housing development.

[4] Program guidelines contractually tie the functional quality of LIHTC housing to investor tax credits for 15 years. Given that the tax benefit for investors is spread over a 10-year period after construction, compliance is enforced by tying the annual distribution of investor tax credits to a host of requirements regarding the affordability and management of the property. It is important to note that the relationship among the investor, developer, and property manager is key in maintaining compliance. Although all tax credits are received in 10 years, contractual obligations extend for the full 15 years.

LIHTC Production in Tribal Statistical Areas

In this section, I provide an overview of LIHTC activity in census-designated tribal statistical areas as compared to census tracts that lie just outside of these boundaries and the rest of the country. The LIHTC database contains information that allows a fairly accurate identification of projects built in tribal statistical areas, such as the location, number of units, and availability date of projects built between 1987 and 2017. As recently as 2017, of the roughly 41,000 LIHTC projects with rental units, approximately 1.5 percent serve tribal statistical areas and 2.8 percent serve neighboring census tracts. Figure 1 shows a high level view of development in tribal statistical areas for the lower 48 states.

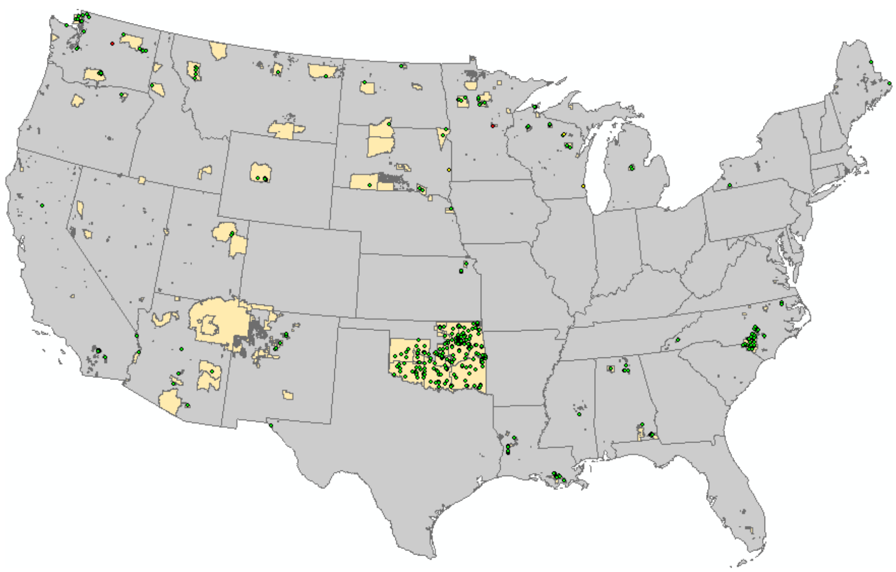

Figure 1. Active LIHTC rental complexes as of December 2017

Each point represents a LIHTC project on tribal lands or less than five miles away. Source: U.S. Department of Housing and Urban Development (HUD) LIHTC database, www.huduser.gov/portal/datasets/lihtc.html.

A large concentration of this construction has taken place in Oklahoma (45.7 percent) and North Carolina (15.4 percent), while vast geographies spanning the Navajo region and the Dakotas have much fewer LIHTC housing units. Supplementing these data with information about population density, land status, and state policy objectives is necessary to understand the real needs of these underserved areas and how much additional housing is required to meet those needs. As depicted in Figure 2, the number of LIHTC projects in tribal areas peaked prior to the recession of 2008 and has not rebounded as of 2015. This likely reflects the general downward trend of LIHTC production in the U.S., as shown in Figure 3, not a specific feature of declining investment in Indian Country.

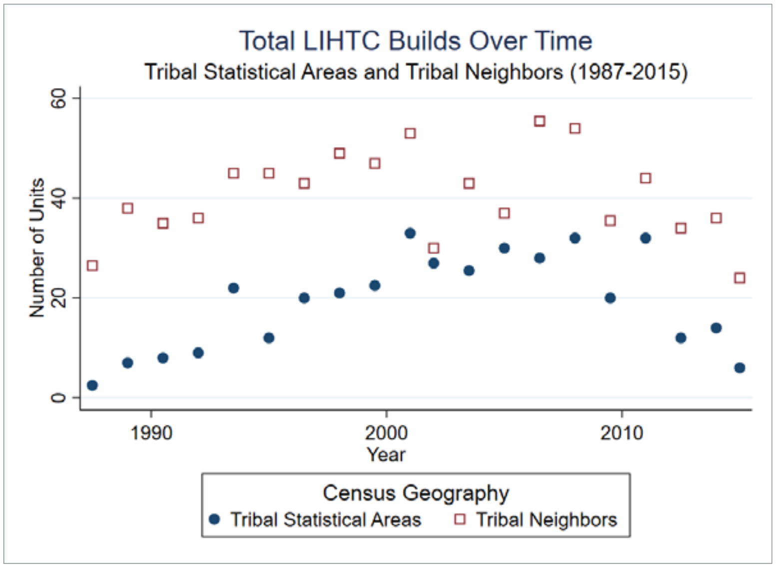

Figure 2. LIHTC development in tribal areas has fallen since the last recession

Each point represents the number of rental units created in each year under LIHTC. The trend shown reflects LIHTC production separately for tribal lands and tribal neighbors—i.e., census tracts along the border of tribal statistical areas. Source: HUD LIHTC database, www.huduser.gov/portal/datasets/lihtc.html.

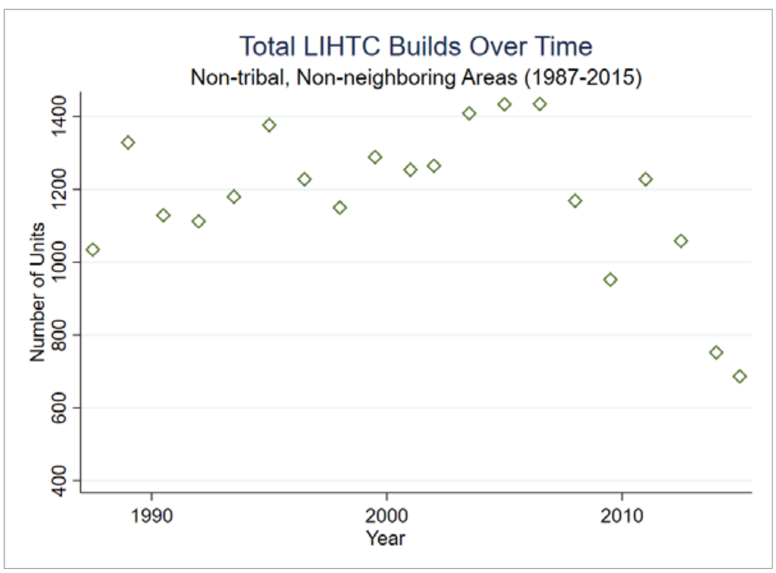

Figure 3. National LIHTC development has also declined since the last recession

Each point represents the number of rental units created in each year under LIHTC. The trend shown reflects LIHTC production in areas of the U.S. aside from tribal lands and tribal neighbors. Source: HUD LIHTC database, www.huduser.gov/portal/datasets/lihtc.html.

The production of LIHTC housing in tribal areas is fundamentally different than in other locations. Figure 4 shows that tribal area LIHTC projects create roughly half the number of rental units as LIHTC projects in other areas. This is a byproduct of the rural, remote nature of tribal lands but also reflects an aspect of LIHTC production unique to tribal areas. Many tribal leaders advocate for increasing homeownership opportunities for tribal members. As such, LIHTC developers on tribal lands utilize a key program provision that allows rental units built under the program to be converted to owner-occupied housing after the 15-year compliance period. As a result, developers often design LIHTC projects in tribal lands featuring many stand-alone, single-family structures instead of one or a few multi-unit buildings. Thus, while LIHTC developers in tribal areas face similar barriers to construction as in other sparsely populated rural areas, the production process may also be fundamentally different.[5]

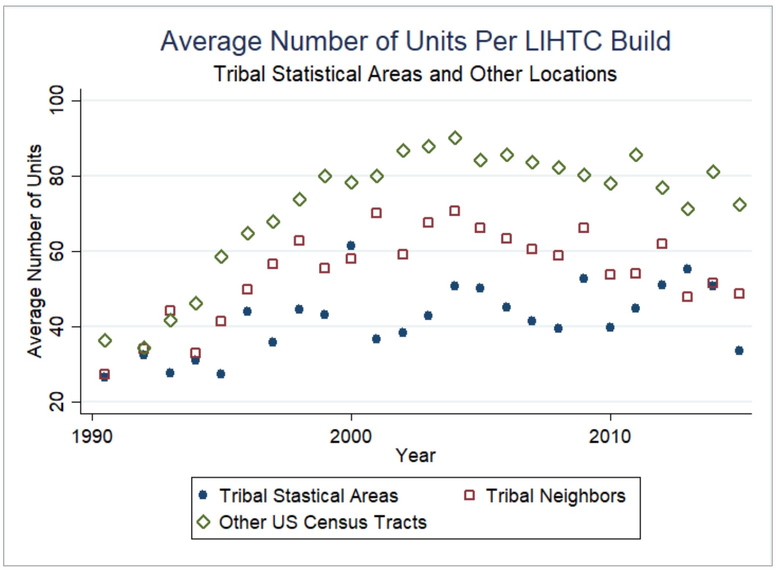

Figure 4: LIHTC development in Indian Country is smaller in scope

Each point represents the average number of rental units per project under LIHTC in different types of areas. Tribal statistical areas include lands for federally and state-recognized tribes. Tribal neighbors are census tracts that border tribal statistical areas. Source: HUD LIHTC database, www.huduser.gov/portal/datasets/lihtc.html.

Future Production and Challenges in Indian Country

These trends bring into question the future role of LIHTC in Indian Country. The demand for tax credits as an investment vehicle will be affected by both the expectation of future tax liabilities and comparable, substitute investments. This is a mechanism of the secondary market in which

[5] There are non-negligible search costs incurred by developers in rural areas. Construction companies with the operational capacity required to produce a LIHTC development are more likely to be located in urban and suburban areas where housing density is higher. This also increases administrative costs, as contractors will require a premium for either temporary housing or travel time between cities and development sites.

developers, awarded tax credits by the state, face competitively determined prices in terms of the value of the individual tax credits. A reduction in the demand for tax credits necessarily reduces the price developers can receive for each dollar of tax credit they possess. Further, investor demand on this secondary market also varies by location of the LIHTC build and reflects investor beliefs about the potential profitability, compliance, and occupancy rate of the project. All of these factors play a role in the amount of working capital developers can raise, with particular applications to Indian Country.

While the federal government has expanded the funding for LIHTC investment as of 2018, the Tax Cuts and Jobs Act of 2017 likely will have a substantive impact on investor demand for tax credits. Most directly, lower income tax rates introduced by this bill reduce the future tax liability for investors, thus decreasing the demand for tax breaks in general. The Tax Cuts and Jobs Act also established Opportunity Zones, designed to provide similar tax breaks for capital investment in distressed areas identified by state governors. It is reasonable to assume this competing program is attractive to potential LIHTC investors and could reduce the market price for LIHTCs.[6]

Another challenge to attracting affordable rental housing development in Indian Country is the complex land ownership structure. Land status in tribal areas generally falls in one of three categories: trust land, fee-simple land, and restricted-fee land (CICD 2018). Roughly half of the land in Indian Country—over 60 million acres—is trust land, the title to which is held by the federal government and subject to tribal jurisdiction. Development on trust land requires an array of federal approvals. However, the larger implication of this trust status is that the land cannot be leveraged as collateral (Leichenko 2018). This is because trust land cannot be sold or encumbered. Leasehold interests on trust land (tribally designated individual property interest) can be used as collateral, but they are not commonly understood or regarded as desirable investments. For example, the extent to which higher transaction costs on trust land affect the location decision for LIHTC development is unknown, but is a considerable challenge for housing investment of any kind (CICD 2018).

Fee-simple land (and to a lesser extent; restricted-fee land) owned by individuals or tribes does not have any restriction on alienation or encumbrance. Development projects on these lands do not require federal approval and carry much lower contracting costs than those on trust land. Historically, fee land in Indian Country has seen much higher levels of development, notably the significant number of LIHTC projects in Oklahoma and North Carolina. All tribal statistical areas

[6] The 2018 Urban Institute study referenced in footnote 3 found evidence that even prior to the signing of the Tax Cuts and Jobs Act, the market price for LIHTCs began to fall in anticipation of a decreased demand for tax credits.

in Oklahoma are fee-simple and home to state-recognized tribes. In North Carolina, the large majority of LIHTC development serves the state-recognized Lumbee Tribe, while only 60 units have been created for the federally recognized Eastern Band of Cherokee. The distribution of LIHTC production in North Carolina is shown in the table below.

LIHTC production in North Carolina

Name	Projects	Total Units
Coharie SDTSA	15	496
Eastern Band of Cherokee Reservation	1	60
Lumbee SDTSA	76	3612
Meherrin SDTSA	4	161

LIHTC development on North Carolina tribal statistical areas. State-recognized tribes reside on state-designated tribal statistical areas (SDTSAs), while the Eastern Band of Cherokee is the federally recognized tribe of North Carolina.

Importantly, studies have shown this difference is not caused by the status of the land (fee vs. trust), but rather by land use restrictions and regulations. As discussed by Akee (2009), once land use restrictions are relaxed, overall housing investment in trust land approaches levels observed in fee-simple land. It is reasonable to assume that land use restrictions on trust land impose a higher cost on potential LIHTC developers as well.

Conclusion

The federal government remains committed to LIHTC as a vehicle for new construction of affordable rental housing. The Consolidated Appropriations Act of 2018 increased the total number of tax credit allocations to states in order to counteract what has been a steady decrease in LIHTC activity following the recession in 2008. While the intended goal of this legislation is to increase LIHTC production, the secondary market for tax credits represents the available capital for developers (Payton Scally et al. 2015). Prices for tax credits are affected by both macroeconomic forces and substitutable investment vehicles that pose a considerable threat to future funding for LIHTC projects.

In states with significant Indian Country populations and trust land, incentives offered in qualified action plans tend to favor Indian Country development. Thus, states are recognizing the demand and necessity for both more housing and subsidized housing in tribal areas and are attempting to bolster development. These state-based investment vehicles for Indian Country housing development go beyond current federal policies that have produced mixed results. Oregon recently introduced new incentives for LIHTC development specifically targeting tribal areas. The continued expansion of state-based incentives for Indian Country development signals the real need for and desire to build more affordable housing in tribal communities.

Restrictions around the use and development of trust land, which make up the majority of tribal areas, have been shown to increase the transaction cost of development in a way that reduces the incentive to build and ultimately the supply of housing. It is not immediately clear whether the state-level incentives are strong enough to overcome the effect of land restrictions on development, but it does require specialized knowledge from tribal leaders to execute LIHTC deals. This is evidenced, in part, by the presence of specialized consulting firms focused entirely on assisting tribal authorities from project approval to tenant management and 15-year compliance (also common in non-tribal projects as well).

Large benefits from LIHTC development on tribal land can be achieved if well-managed and well-executed. Multi-family housing development also could be a solution to the housing quantity and quality challenges faced in Indian Country. One concern is the opportunity of homeownership for families on tribal lands and programs designed specifically for that objective. Support of rental housing development should not necessarily compete with programs designed to increase owner occupancy if short-run housing stability in the form of quality renting can increase the long-run probability of homeownership. Development under the LIHTC program does, however, push forward the broader goal of accessibility of secure, affordable housing through increased investment.

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