Wall Street bets on tax cuts as affordable housing pays the price

Politico, by Lorraine Woellert, March 14, 2017, 03:03 PM EDT, updated 03/08/17 07:30 AM EST

Wall Street is betting on corporate tax reform, and the wager is having an unforeseen impact on one market before Congress has even taken up a bill.

Investors began losing their appetite for federal low-income housing tax credits immediately after Election Day, when the Republican sweep of the White House and Congress suddenly made broad reform a real possibility. Now, fewer companies are willing to pay top dollar for the credits, which are sold to finance affordable housing and urban renewal.

Wall Street's optimism is causing pain from Oregon to Massachusetts as development projects face unexpected funding shortfalls. In Milwaukee, a $1 tax credit was worth more than a dollar to investors before the election. Now that same credit is worth about 93 cents, creating a $515,000 financing gap on a long-planned low-income housing project.

"We were getting over a dollar for those credits, then they kept going down starting around the election," said Michael Goldberg, executive director of the nonprofit Heartland Alliance, an anti-poverty group trying to convert an old Milwaukee hospital into 60 apartments. "For a while it had dropped to about 95 cents. Currently, the best offer we have is about 93 cents. It's really a dramatic shift for nothing really happening."

The low-income housing tax credit, signed into law by President Ronald Reagan in 1986, encourages banks and other companies to invest in inexpensive rental apartments and houses that aren't profitable enough to be built using typical financing.

The federal subsidy allocates $2.35 in tax credits for every state resident. State agencies dole out the credits to developers who usually sell them to finance low-rent projects. The program creates about 100,000 affordable housing units a year, according to the National Council of State Housing Agencies. This year, it will cost taxpayers about $8 billion in federal revenue.

Banks and other companies buy housing and other types of federal tax credits to reduce what they owe to the Internal Revenue Service. A Republican tax reform blueprint would preserve the low-income housing tax credit, but it also would lower the corporate tax rate from 35 percent to a flat 20 percent, making the credits less valuable. Donald Trump campaigned for president on a 15 percent corporate rate.

With reform on the horizon, investors who had bought into tax credit deals before the election now are having second thoughts.

"Our phone was ringing from investors that were, in some cases, in discussions or had letters of intent. They were saying they couldn't go through with the pricing," said Dick Burns, chief executive officer of the NHP Foundation, which owns low-rent properties in 15 states and Washington, D.C. "We're just beside ourselves."

This week, Sens. Orrin Hatch (R-Utah) and Maria Cantwell (D-Wash.) are expected to introduce a bill to expand the pool of low-income housing tax credits by 50 percent over the next five years.

The measure would make more rental units available to the lowest-income households. It would also prevent local officials from blocking tax-credit projects, a provision aimed at the not-in-my-backyard activists who routinely thwart low-income development.

A 50-state coalition of more than 2,000 for- and non-profit developers, churches, housing advocates, banks, builders and community leaders is rallying to support the bill.

"This is the best affordable housing rental development tool we've ever had," said Barbara Thompson, executive director of the National Council of State Housing Agencies. "We need to preserve it."

A 50 percent increase in housing tax credits might cover the pricing gap, but it won't be enough to meet the need for more low-cost rentals.

Older tax-credit funded apartment buildings are reaching the end of their lifespans and soon will need rehabilitation. Others will simply fall out of the program by letting their tax credits — and the affordability requirements that go with them — expire, converting to higher rents.

As the pace of new construction lags, rising rents and sluggish wage growth have created shortage of 7.4 million homes for the lowest-income households, according to the National Low Income Housing Coalition.

The recent drop in pricing could reduce the stock of affordable housing by as many as 20,000 units a year over the next decade, said Michael Novogradac, managing partner of an accounting firm that specializes in tax credits.

With federal subsidies scarce even now, developers already must cobble together financing from multiple sources, a process that takes time, raises costs and increases the chance of something going wrong. Heartland's hospital renovation in Milwaukee currently has nine sources of funding.

Post-election volatility has made the math even more complicated. Developers who can't cajole states, localities and non-profits to bridge their last-minute funding gaps are racing to redesign projects with fewer units, cheaper construction materials or less-efficient heating and cooling. Missed deadlines could cause fragile multiparty financing deals to collapse.

In Milwaukee, Heartland has appealed to the city for more funding to rehabilitate the historic hospital, which was built by a Catholic parish in 1930 to employ and treat African-Americans. Goldberg, who remains hopeful the project will break ground in July as planned, called the federal tax credit a "precious resource."

"This is a great public-private partnership, but it's still based on market demand," Goldberg said. "I don't know what the fix is."