CAN THE HOUSING TAX CREDIT BE A MODEL FOR CONNECTING CAPITAL TO MORE HUMAN-CENTERED OUTCOMES?

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In Cleveland's Buckeye neighborhood stands Saint Luke's Manor, a former hospital that closed in 1999 and remained vacant for more than a decade. Over time, Saint Luke's became a target for vandalism, an eyesore for residents, and a symbol of neighborhood neglect and decay. Its surrounding streets became lined with empty lots and boarded homes.

Fast-forward to today. Saint Luke's is an anchor for the community: home to 137 quality, affordable senior apartments, office space for nonprofits, and an 80,000-square-foot learning campus that hosts a top-performing charter school and after-school programs through the local Boys and Girls Club. Saint Luke's is located on the transit line and is surrounded by new homes being built and sold on adjoining streets, reflecting the broader neighborhood's revitalization. One current tenant of Saint Luke's says, "I have no fear now that I live at Saint Luke's to leave my windows open. I am proud to be living in such a beautiful place."

What explains this transformation? How did a complex, multi-faceted effort requiring millions of dollars in financing—far more than the local government or foundation dollars available to meet it—come together so effectively? The answer: the federal tax code.

In addition to the determination and effectiveness of local partners, the transformation was made possible by investment tax credits that encourage the flow of private capital into low-income communities and demonstrate outcomes-based financing in action—in particular, the Low Income Housing Tax Credit (the Housing Credit).

HOUSING TAX CREDITS ARE A LONGSTANDING PAY FOR SUCCESS PROGRAM

For three decades, the community development sector has used the Housing Credit to provide housing for people who would otherwise struggle to find an affordable place to call home. The Housing Credit is an undeniable success story in public-private partnerships, financing virtually all of the country's affordable housing construction since the late 1980s—over three million affordable homes and counting.[1]

We should be proud of this. These are quality homes that give people stability and an essential platform to opportunity—quality education, jobs, health care, transportation, and other critical community services. Less understood is that the Housing Credit is a true pay-for-outcomes financing program: The federal government pays for those high-quality homes only if and when the homes have been built and leased to the target population.

The success of the Housing Credit invites us to consider how we might build on the model. Could we use this proven approach to physical capital development (real estate) to develop *human* capital (health, education, etc.)? What if we were to include metrics that revealed how the residents in homes financed by the Housing Credit are doing, such as their health or their access to quality schools and jobs? What if we had an evaluative component that goes beyond the "bricks and sticks" and creates financial incentives to reward developers who can demonstrate that their residents are positively, *measurably* transforming their lives? And what if we provided resources and incentives to reward those outcomes? What if, instead of—or in addition to—tying capital to the provision of quality, affordable homes, we tied it to outcomes like "ready to learn at kindergarten," or "graduation from high school," or the "successful long-term employment for a former prisoner?"

Three decades after the origination of the Housing Credit, the time is right to look ahead to the next three decades. In addition to expanding the Housing Credit program to enable the provision of more badly needed affordable homes, we should consider how we might build on the model to produce all types of transformative outcomes for residents—not just

1 National Council of State Housing Agencies, "2016 Message on the Housing Credit" (February 26, 2016), available at https://www.ncsha.org/resource/2016-message-housing-credit.

by providing access to housing, but by ensuring that their homes serve as true platforms to good health, quality education, employment, and whatever else they need to prosper.

How the Low Income Housing Tax Credit Works

For a project to be eligible for the Housing Credit, a certain percentage of units must be rent-restricted and occupied by households earning below a certain income level. Private investors, not the government, provide money to cover development costs and are on the hook for most financial risks. In exchange, the investor is given a federal tax credit, redeemable only when construction is completed and the low-income residents move into the new homes. The final payments come when the investor receives IRS Form 8609, a certification of a successfully operating affordable housing project that is leased to low-income renters.

Importantly, the rent must stay affordable for a minimum of 30 years (although in most cases the affordability restrictions are longer), and there is also ongoing monitoring of the property to ensure that it stays affordable. During the initial 15-year window, the government can recapture tax credits in the event of noncompliance. This pay-for-performance mechanism has an elegant way of infusing market discipline while ensuring that the federal government pays only when the desired outcome is achieved.[2]

Building on the success of the Housing Credit, the New Markets Tax Credit was created in 2000 to encourage private investment for "near bankable" deals in low-income communities where capital doesn't naturally tend to flow.[3] The program allows individual and corporate investors to reduce their federal income tax burden in exchange for a qualified equity investment in a community development entity, which uses that money to fund businesses and real estate projects, such as charter schools, health care clinics, and other key community assets.

2 For an overview of the Housing Credit, see David J. Erickson, *Housing Policy Revolution: Networks and Neighborhoods* (Washington, DC: Urban Institute Press, 2009).

3 For a good overview on the origins of the New Markets Tax Credit program, see Benson F. Roberts, "The Political History of and Prospects for Reauthorizing New Markets," *Community Development Investment Review* 1 (1) (2005): 21–32, available at http://www.frbsf.org/community-development/files/cdirvol1issue1.pdf.

When used together, these two tax credit programs can have a transformative impact on low-income communities. Saint Luke's Manor, for example, received over $19 million in Housing Credit equity, helping to finance the affordable homes for seniors mentioned earlier. The other facilities, including the charter school and after-school program center, were made possible by $5 million in New Markets Tax Credits.[4] All told, it took multiple creatively assembled sources of financing—a "capital stack" of tax credit equity, multi-sector partnerships, and local support—to pull off the successful six-year revitalization effort in this historically disinvested community. Without the tax credits, none of it would have been possible.[5]

Building on a Successful Model

A Housing Credit investment generates a clear, positive social outcome: an affordable home. The social benefits of an affordable home cannot be overstated; they include physical, emotional, and financial stability for residents—a true springboard for opportunity.

But it invites us to ask: What if we built on this model, using financial incentives linked directly to outcomes for the residents (the people as well as the place)—their improvements in health, financial growth, educational advancements, or employability? What might that look like?

Consider the basic characteristics of the Housing Credit program. For one, you have a clear and measurable *outcome* you are looking to achieve (an affordable home over a sustained period of time). You also have a *market incentive* that attracts investment toward that outcome, as well as a *monitoring and measurement requirement* to ensure that the outcome has, in fact, been achieved. There is also a *policy structure* that catalyzes public-private partnerships on a large scale and a mechanism to *recapture* the investment if the outcome is not achieved. These are the core components.

Using these essential ingredients of the Housing Credit program to engineer a model designed around a different type of outcome, we arrive at a potential path, one that builds on Housing Credit investments with additional tax credits tied to a layered-on outcome—what we might call "extra credit(s)." Below is a glimpse of how such a program could look.

4 The Saint Luke's Manor project was also made possible by Historic Tax Credit equity.

5 Enterprise Community Partners, Inc. worked in close partnership with Pennrose Properties and Cleveland Neighborhood Progress on Saint Luke's Manor.

Adding Human Capital Outcomes to Investment Tax Credits

The Housing Credit program works remarkably well to produce housing and it should be maintained (in fact, the program should receive dramatically more federal funding to address the severe shortage of affordable units). But imagine if we also took the Housing Credit one step further—by adding on tax credits that are tied to more human-centered outcomes. It is one thing to build a financial model around the occupancy or conditions of a unit. It is quite another to build a model around a parent's rising wages or a student's educational advancement. But it can be done.

For this to work, a critical support activity would be offered on a Housing Credit property (e.g., onsite daycare, after-school transportation, job training, or a partnership with a health clinic for youth or senior wellness visits), which would require an upfront investment that covers startup and ongoing operating costs. That activity would be supported by an award of additional tax credits, which could come in a lump-sum using equity from an investor who buys the tax credits.

One of the virtues of the Housing Credit program is that through the allocation process, states are able to address the needs unique to their local communities, such as housing in rural areas or supportive housing designed to serve especially vulnerable populations, such as frail elderly or formerly homeless. In the same way, extra credit funding could be matched with existing social programs, building on the successful work already being done and tailored to local needs. The program could even require a match to improve the leverage of the extra credit program, and municipalities that are currently providing funding for existing programs could use the extra credit program to make their local dollars go even further.

Imagine, for example, a "Bright Eyes Education Tax Credit" (per Len Syme's dedication in this book), where credits are issued as a child moves through the education system successfully. You could imagine a tax credit certification at the following stages: 1) the completion of successful post-partum home visiting sessions; 2) arriving at kindergarten ready to learn; 3) reading at grade level in third grade; 4) math proficiency in eighth grade; and, finally, 5) high school graduation.[6]

6 For more information, a similar concept was explored by Ian Galloway in "Charter School Tax Credit: Investing in Human Capital," Federal Reserve Bank of San Francisco (December 1, 2010), available at http://www.frbsf.org/community-development/publications/working-papers/2010/december/investment-tax-credits-charter-schools/.

Or consider a "Jobs for All Tax Credit," where credits are issued when certain workforce milestones are reached for an adult struggling to find or hold employment, such as: 1) an effective onsite jobs training program is held; 2) a job is secured by the individual; and 3) he or she is still employed after two years. Or something along those lines.

Such programs would apply to people living in Housing Credit properties, hence the "extra credit" aspect. So, imagine if an 80-unit property receiving Housing Credits also received $2,000 per year per unit to spend on programs that directly served the residents, and one-third of the cost for the first five years would come from the extra credits, with the remainder from local sources. In this example, the extra credit proceeds would total $267,000, which could only be used for a resident-focused program or set of programs that were defined in advance of allocation—such as the Bright Eyes Education Tax Credit or the Jobs for All Tax Credit.[7] Over the course of the five-year pilot, outcomes generated by those programs would be carefully measured and evaluated against certain milestones like those above, and the government would allocate credits if and when the milestones are achieved.

The same core mechanisms in the Housing Credit program would be featured in the extra credit program. You would have clearly defined *outcomes*, such as those suggested in the examples earlier. Your *market incentives* would be similar to those of the Housing Credit—the prospect of a dollar-for-dollar reduction on investors' tax liability, as well as the potential for financial returns. Also, like the Housing Credit program, you would have a *monitoring and measurement requirement*, carried out perhaps by the relevant city or state agency, depending on the nature of the program (monitoring of Housing Credit properties, for example, is typically done by state housing agencies). And, of course, the extra tax credit program would need the enabling *policy structure*, including changes in the tax code.

As with any new program, we could start small, test it, adjust it, and then expand it. We could experiment with a program like this in several states so that we have comparative approaches for implementation. From there,

7 How the $267,000 figure was derived: an 80-unit project in which $2,000 per unit is allocated over five years (80 x 2,000 x 5 = 800,000); one-third of that cost is covered by equity from the "extra credits" (800,000/3 = $267,000).

if successful, the program could expand and become a permanent feature in the federal tax code.

Building on Low Income Housing Tax Credits and Investing in What Works

With such a model, all stakeholders stand to win: Investors have a financial incentive to provide additional funding; the federal government's dollars are being put to good use since it is paying for what works; local governments, who provide funding for local supportive services (which is usually insufficient to meet the needs), are able to further leverage what they are already doing; and, of course, residents themselves benefit from services that are stronger and held to greater accountability.

The investment tax ecosystem for physical capital development is scaled and sophisticated and involves the necessary expertise from a range of industries: law firms, Wall Street, real estate investment, design and construction, and human services providers. We have shown that when the federal government uses subsidy dollars to create an outcomes orientation—or quasi market—it can create enormous efficiencies and incredible transformations, such as Saint Luke's Manor in Cleveland.

More human-centered transformations, such as education outcomes for children or sustained employment for adults, require more complex interventions over longer periods of time than making homes affordable. But that is no reason to doubt that we can create the sophisticated and scaled ecosystem to execute on these types of outcomes, too. The time has come to use the Housing Credit's core mechanisms—that have worked for over 30 years—to create a new market and policy infrastructure that helps us turn the tide on inadequate educational achievement, insufficient job opportunities, health disparities, and other inequities that prevent people from reaching their potential.

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