PRRAC
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What can the Treasury Department do to expand public and community ownership of rental housing?

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Introduction

The United States is experiencing a housing crisis as Americans face a shortage of affordable housing supply and rapidly increasing housing costs. Far too many individuals and families across the country face housing insecurity, homelessness, and unsustainable rental burdens. In response to these challenges, a national housing movement has emerged to expand the social housing sector and move away from for-profit housing. These principles are rooted in the belief that housing is a human right rather than a commodity.[2] The social housing sector is not any single financing structure but includes public housing, community land trusts and related tenant cooperative models, and other forms of non-profit or community housing ownership and management.[3]

The social housing movement has gained momentum in recent years, particularly as Americans face increasingly unaffordable, unsustainable rent burdens and the COVID-19 pandemic. This housing movement has urged a shift in how housing is built, owned, and operated so that the right to housing can one day be secured for all. Support from existing federal programs can

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2 The Alliance for Housing Justice has published a set of defining principles for social housing in the U.S. at https://www.allianceforhousingjustice.org/us-social-housing-principles.

3 Chew, Amee, Social Housing For All: A Vision For Thriving Communities, Renter Power, and Racial Justice, The Center for Popular Democracy (March 2022) https://www.populardemocracy.org/sites/default/files/Social%20Housing%20for%20All%20-%20English%20-%20FINAL%203-21-2022_0.pdf

play a crucial role in expanding social housing and moving away from for-profit housing models to support low-income families. In a previous policy brief,[4] we explored the role that the U.S. Department of Housing and Urban Development (HUD) can play in supporting the social housing sector. We now expand upon that policy exploration to discuss what actions the U.S. Department of the Treasury can take to further social housing principles and goals.

The Treasury Department has a significant impact on housing development through the Low-Income Housing Tax Credit (LIHTC) program, the Community Development Financial Institutions (CDFI) Fund, and the Capital Magnet Fund. Opportunity Zones are another tool that Treasury can use to influence affordable housing development and potentially expand community ownership. This policy brief will explore how the Treasury Department might play a larger role in supporting social housing.

The Low-Income Housing Tax Credit Program

The Low-Income Housing Tax Credit (LIHTC) program is the single largest source of federal funding for affordable housing in the United States.[5] LIHTC was first authorized in 1986 and helped finance more than 3.4 million housing units between 1987 and 2020.[6] LIHTC is administered jointly by the U.S. Department of the Treasury and state housing finance agencies (HFAs). The Internal Revenue Service (IRS) allocates tax credits to states, and state HFAs use qualified allocation plans (QAPs) to outline the criteria used to select which projects will be awarded tax credits. Owners or developers of a project typically partner with investors who receive tax credits in exchange for equity investments to finance construction. Selling tax credits to investors allows developers to borrow less money for construction and charge lower rents. LIHTC projects are required to remain affordable for 30 years, though some states impose affordability requirements longer than 30 years.[7] The LIHTC program is a potential vehicle for social housing if long-term or permanent affordability can be guaranteed.

Securing the Right of First Refusal (ROFR)

Under Section 42(i)(7) of the Internal Revenue Code (IRC), a resident management corporation of a building, a qualified nonprofit organization as defined in IRC §42(h) (5) (C), or government agency may hold a right to purchase a LIHTC building after the close of the building's 15-year "compliance period" at a below-market rate.[8] However, recent challenges to

4 Tegeler, Philip, "What can HUD do to expand public and community ownership of rental housing?" Poverty & Race Research Action Council (April 2021) https://prrac.org/pdf/hud-social-housing-2021.pdf.

5 U.S. Government Accountability Office, Low-Income Housing Tax Credit: The Role of Syndicators (Feb. 16, 2017), https://www.gao.gov/assets/gao-17-285r.pdf

6 HUD office of Policy Dev. And Research, Low-Income Housing Tax Credit: Property Level Data https://www.huduser.gov/portal/datasets/lihtc/property.html

7 See "Social Housing Goals in State Housing Allocation Plans: A 50-State Survey" (PRRAC, 2023), https://prrac.org/pdf/Social-Housing-50-state-survey.pdf

8 IRC 42(i)(7), https://www.irs.gov/pub/irs-utl/IRC_42.pdf

the statutory right of first refusal have created statutory ambiguity, threatening nonprofit control of LIHTC-funded properties.[9] Specifically, it has become unclear if the ROFR in the LIHTC program refers to a common law ROFR which is triggered by an enforceable bona fide offer from an unrelated third party or if it is something unique that does not require a third party offer to be triggered.[10] The ambiguity of the ROFR provision has led to outside for-profit entities disputing transfers to nonprofits, undermining this crucial social housing provision of the LIHTC program.

To address the growing issues around the right of first refusal provision and to prevent the loss of nonprofit control of housing for LIHTC projects that are approaching the end of the 15-year compliance period, updated rules should be adopted. A legislative solution to the problem has previously been proposed in Congress[11] and several states have tried to address the issue.[12] However, the IRS has never issued guidance on §42(i)(7). The IRS should address the issue in its Priority Guidance Plan[13] to clarify how the ROFR operates in the LIHTC program. The agency should clearly state that 1) the LIHTC ROFR is a special right of first refusal under federal law and not a common law or state law right of first refusal, 2) that no offer from a third party is required to trigger the ROFR, and 3) that the ROFR may be initiated by an offer from any qualified entity. The National Housing Trust has developed recommended language for states to include in their Qualified Allocation Plans to protect the ROFR,[14] but leadership from the Treasury will be important in preserving this important social housing tool.

Increasing nonprofit set-asides

Currently, under 26 U.S.C. §42(h)(5)(B), at least 10% of state LIHTC credits must be allocated to qualified nonprofit organizations, usually operating as managing or general partners on behalf of a group of for-profit investors.[15] IRS Revenue Procedure 96-32 provides more information to determine what organizations count as a qualified nonprofit.[16] It is unlikely that the Treasury Department has the power to increase the minimum statutory set-aside, but state Housing Finance Agencies have that discretion, and several states have adopted incentives for

9 Brandon Duong, Losing Nonprofit Control of Tax Credit Housing?, Shelterforce (Oct. 16, 2020) https://shelterforce.org/2020/10/16/refusing-the-right-to-refuse/?fbclid=IwAR0TVk1Q829D5T51fxVA4wyoRIh_glGbRPR-3OshWanvS8IZkzSPJkClxCI

10 *Id.*

11 The Affordable Housing Credit Improvement Act of 2019 (S. 1703/H.R. 3077)

12 See "Social Housing Goals in State Housing Plans," supra note 7.

13 IRS Priority Guidance Plan, IRS https://www.irs.gov/privacy-disclosure/priority-guidance-plan

14 See https://nationalhousingtrust.org/news/nht-offers-toolkit-help-housing-agencies-strengthen-right-first-refusal-provisions-promoting.

15 The wording of 26 U.S.C. §42(h)(5)(B) actually sets a 90% "cap" on for-profit ownership, but in practice this operates as a 10% minimum requirement.

16 IRS Revenue Procedure 96-32 https://www.irs.gov/pub/irs-tege/rp_1996-32.pdf

non-profit ownership.[17] The Treasury Department could also incentivize non-profit ownership in LIHTC by prioritizing Capital Magnet Fund awards specifically to non-profit LIHTC developers and owners (see below).

Encouraging best practices in state Qualified Allocation Plans (QAPs)

State QAPs are fundamental to the administration of the LIHTC program and states have wide discretion to determine what criteria they will use for allocation. The Treasury Department exercises little control over the content of state QAPs beyond the minimum statutory requirements,[18] but the agency could play a leadership role in encouraging states, through guidance or special grants, to support state expansion of non-profit or community-controlled housing setasides and other elements of social housing. Some examples of progressive state QAP provisions supporting tenants' rights and social housing include longer affordability periods, increased non-profit setasides, greater community oversight, protections from displacement in redevelopment projects, and encouragement for alternative ownership models.[19]

Community Development Financial Institutions (CDFI) Fund and the Capital Magnet Fund

The CDFI Fund was authorized by the Riegle Community Development and Regulatory Improvement Act of 1994 to promote economic revitalization and community development through consumer, residential real estate, and small business financial services.[20]

As of February 14, 2022, the CDFI Fund has certified 1,390 CDFIs.[21] The CDFI Coalition identifies six basic types of CDFIs: Community Development Banks (for profit), Community Development Credit Unions (non-profit), Community Development Loan Funds (mostly non-profit), Microenterprise Development Loan Funds (non-profit), and Community Development Corporations (non-profit).[22] Most of these institutions have some form of community oversight or control.[23] It has been estimated that 20% of CDFIs are for-profit institutions.[24] However, non-profit versus for profit status is not reported in the CDFI Master List or in aggregate data reports.

17 Social Housing Goals in State Housing Plans, supra note 7

18 26 USC § 42(m)(1)

19 See Social Housing Goals in State Housing Plans, supra note 7

20 12 U.S.C. § 4701;

21 *See CDFI Master List* at https://view.officeapps.live.com/op/view.aspx?src=https%3A%2F%2Fwww.cdfifund.gov%2Fsites%2Fcdfi%2Ffiles%2F2022-02%2FCDFI_Cert_List_02_14_2022_Final.xlsx&wdOrigin=BROWSELINK

22 https://cdfi.org/about-cdfis/cdfi-types/

23 Id.

24 The Best Kept Secrets of the CDFI Sector, *Center for Community Investment* (Aug. 23, 2022) https://centerforcommunityinvestment.org/news/the-best-kept-secrets-of-the-cdfi-sector/

CDFIs make significant investments in affordable rental housing – supporting more than 53,000 units in 2021, for example.[25] Since the vast majority of CDFIs are non-profits with significant community oversight, we might expect to see a majority of affordable housing investments in non-profit developments with community ownership or control. However, the mix of for-profit vs non-profit housing investments by CDFIs does not appear to be tracked. Recognizing that communities being targeted for revitalization are often simultaneously being targeted for exploitation, it is important that CDFIs be encouraged or required to avoid supporting for-profit housing development in poor neighborhoods, and to implement the principles of social housing.

How could the CDFI Fund assist in supporting an expanded social housing sector and encouraging community control or ownership of housing?

- **Begin reporting profit vs non-profit status of certified CDFIs:** Depending on their business structure, for-profit entities inherently have a competing primary goal or even fiduciary duty to earn profit.[26] The CDFI Fund should report certified CDFIs' legal entity type in future Master Lists to identify the flow of funds to for-profit vs non-profit institutions.

- **Track and incent investments in non-profit and community-controlled affordable housing:** Rental housing investments by CDFIs should be consistent with the primary mission test for CDFIs and promote community and non-profit ownership.

- **Safeguard the CDFI name by certifying/recertifying only mission-based organizations:** Profit-motive must be closely examined in the primary mission test.[27] The "primary mission" test in the CDFI certification process provides opportunity for the CDFI Fund to exclude applicants with wealth-extractive practices and investments. We commend the CDFI Fund's deliberate and extensive efforts to update the CDFI Certification Application, particularly the new inclusion of bright-line questions related to an organization's lending and financing practices.[28] In upcoming implementation of the new CDFI Certification Application, the Fund should continue to define and ban certain exploitative practices that are not appropriate for CDFIs.[29]

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25 https://www.cdfifund.gov/programs-training/programs/cdfi-program.

26 See *Burwell v. Hobby Lobby Stores, Inc.*, 573 U.S. 682 (2014)

27 It is important to note that a "mission" as described under 501(c)3 exempt purposes is not synonymous with corporate "guiding principles" or "vision statements."

28 *Further Updates on Revisions to the CDFI Certification Application*, CDFI Fund (May 1, 2023) https://www.cdfifund.gov/news/520; See also CDFI Certification Application Request for Comment, 87 Fed. Reg. 66,786 (Nov. 4, 2022); 12 CFR § 1805 (2017).

29 These concerns were partially addressed by some commenters in the recent request for public comment. We echo and support the recommendation of the HOPE Credit Union Enterprise Corporation Policy Institute to

- **Ensure Target Markets are receiving funds.** The CDFI program has faced criticism that its assets are not reaching its intended target markets.[30] The Treasury's commitment that Applicants must meet both number and dollar amount activity thresholds will help ensure that CDFIs continue to serve their target populations as a primary organizational focus.

- **Provide additional guidance on accountability requirements that offer meaningful oversight by community members, both in CDFIs and in CDFI housing investments.**

The Capital Magnet Fund

The Capital Magnet Fund (CMF) is the only program administered through the CDFI Fund dedicated specifically to the development of affordable housing, and presents the Fund's greatest opportunity to expand social housing. Established through the Housing and Economic Recovery Act of 2008, the CMF was created with the affordable housing crisis in mind. Importantly, the statute creating the CMF gives the Treasury Department enormous discretion in setting priorities for grants, which could include social housing program goals.

The Capital Magnet Fund starts off with a non-profit focus: applicants must be a certified CDFI or a nonprofit organization that has a primary purpose of developing or managing affordable housing. At least 70 percent of Capital Magnet Fund dollars must be used to finance affordable housing.[31] Currently, applications for funding are evaluated in three areas 1) business and leveraging strategy 2) community impact, and 3) organizational capacity.

CMF projects are subject to a minimum 10-year affordability period, as established by 12 CFR 1807.401. However, the statutory authority that established and governs the CMF makes no mention of any limitation to affordability periods imposed by the program.[32] Treasury should amend the regulatory authority to impose much longer term affordability requirements, such as the 30-year period required under LIHTC – or longer. CMF investments should also be tracked to ensure that funding for affordable housing is supporting non-profit, community-based developments, and that the locations of CMF-funded developments are consistent with the Affirmatively Furthering Fair Housing mandate of the Fair Housing Act.

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name overdraft fees and insufficient fund fees as examples of practices counter to the CDFI mission. Hope Credit Union Enterprise Corporation Policy Institute, Public Comment OMB Control Number: 1559:0028 (Dec. 5, 2022) http://hopepolicy.org/manage/wp-content/uploads/HOPE-CDFI-Certification-Public-Comment-FINAL.pdf

30 Burt, Kiyadh, Analyzing the CDFI Asset Gap: Examining Racial Disparities in CDFI Fund Awardees from 2003 to 2017 (Nov. 5, 2020).

31 12 U.S.C. § 4569; 12 C.F.R. § 1807

32 12 U.S.C.A. § 4569

Opportunity Zones

Opportunity Zones[33] (OZs) were created under the Tax Cuts and Jobs Act of 2017 and permit investors who invest in certain distressed areas (defined at the census tract level) to defer capital gains.[34] Governors recommend census tracts to be certified by the IRS as Qualified Opportunity Zones. Since its inception, the Opportunity Zones incentive has faced substantial criticism. Advocates have raised concerns about OZs because there is limited oversight of the incentive, a lack of performance standards, and a lack of safeguards to prevent displacement.[35] In addition, the benefits of the program largely flow to wealthy investors,[36] and to for-profit projects, while mission-based actors face challenges in attracting investment.[37]

Reforms to the Opportunity Zones tax incentive could help ensure that more investment can be used for social housing that benefits low-income people. Policymakers could take some of the following steps to require meaningful reporting and establish strong criteria for eligible housing investment.

- **Certify that Funds will Provide Community Benefits**
- **Enact Meaningful Reporting Requirements:** Current regulations do not require data collection and meaningful reporting of the results of activities in Opportunity Zones.
- **Coordination:** Treasury could improve coordination between qualified opportunity funds, PHAs, local and state governments, and HUD to ensure that opportunity zones are receiving housing investment. Treasury could also include requirements for investment in opportunity zones to benefit communities and expand community ownership of housing.

In conclusion, as the United States grapples with an affordable housing crisis, the need for transformative change in housing policies becomes ever more pressing. The social housing movement, anchored in the belief that housing is a fundamental right and not a commodity, offers a comprehensive vision for the future of housing. The Treasury Department, through its diverse portfolio of programs, is in a unique position to spearhead a shift toward social housing.

33 26 U.S.C. §1400Z-2; 26 CFR § 1.1400Z(2)(a)-1

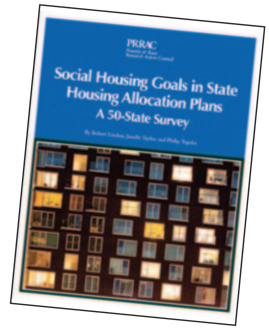
34 Ed Gramlich, National Low Income Housing Coalition, Opportunity Zones https://nlihc.org/sites/default/files/2022-03/2022AG_8-03_Opportunity-Zones.pdf

35 National Housing Law Project, Reform Opportunity Zones, https://www.nhlp.org/wp-content/uploads/Transition-OZ.pdf

36 National Housing Law Project, Reform Opportunity Zones, https://www.nhlp.org/wp-content/uploads/Transition-OZ.pdf; Center on Budget and Policy Priorities, *Potential Flaws of Opportunity Zones Loom, as Do Risks of Large-Scale Tax Avoidance*, (Jan. 11, 2019) https://www.cbpp.org/research/federal-tax/potential-flaws-of-opportunity-zones-loom-as-do-risks-of-large-scale-tax

37 Brett Theodos et al, Urban Institute, An Early Assessment of Opportunity Zones for Equitable Development Projects (June 2020), https://www.urban.org/sites/default/files/publication/102348/early-assessment-of-opportunity-zones-for-equitable-development-projects.pdf

Related resources from Poverty & Race Research Action Council (PRRAC):



Social Housing Goals in State Housing Allocation Plans – A 50-State Survey

By Robert Lindsay, Janelle Taylor, and Philip Tegeler, December 2023

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