Notes from Moelis Institute Convening on CBPP Proposal for a New Renters’ Federal Tax Credit

On October 1, 2012, the Furman Center’s Moelis Institute for Affordable Housing Policy hosted a roundtable discussion on the recent proposal for a new renters’ federal tax credit by the Center for Budget and Policy Priorities (CBPP). The roundtable provided an opportunity for New York City affordable housing practitioners, academics and policymakers to learn about an emerging federal housing policy idea and provide useful feedback on the proposal during its early development stage.

Barbara Sard, Vice President for Housing Policy at the Center for Budget and Policy Priorities, presented an overview of their proposed renter tax credit. Briefly, CBPP has proposed a new renters’ credit. The federal income tax credits would be allocated by the federal government to states in a manner similar to that for the Low Income Housing Tax Credit (LIHTC). States would then be responsible for distributing the credits in a manner consistent with the needs and priorities that they identify. Property owners (or possibly the banks that lend to them) would claim the credit in exchange for providing housing at a rent of no more than 30 percent of a family’s income. CBPP estimates that this credit would make housing affordable to 1.2 million low-income renters.1 Ms. Sard explained that this proposal was created in response to asymmetries in the current tax system, which provides a higher share of tax benefits to homeowners and thus, higher-income households. While acknowledging the political and fiscal challenges to creating a new program, she was optimistic that tax reform in 2013 will result in changes to the existing system, creating an opportunity to advance the renter tax credit proposal. Additionally, she stated that the program was structured to incentivize bank and property owner participation, while at the same time avoiding any political roadblocks resulting from administrative complexities or significant funding requests.

The program overview included an explanation of various choices CBPP made in structuring the tax credit and was followed by a group discussion moderated by the Furman Center’s Vicki Been and Ingrid Gould Ellen. The dialogue covered many topics related to the implementation of the program, the logic behind specific policy choices, and how the renter credit would interact with the LIHTC program. Participants also offered their assessments of the program and proposed possible adjustments based on specific policy and operational concerns, stemming from their own experiences with similar programs. The three major points of discussion, detailed below, centered on attracting landlord and bank participation the proposed program’s interaction with the LIHTC program and the political feasibility of creating a new program for low-income renters. Several other issues that received less attention are described at the end of this memo.

**Topic #1: Securing Landlord and Bank Participation**

Although the proposed renters’ tax credit aims to make housing more affordable to low-income households, one of its defining characteristics is that the credit would not be claimed by individual renters. Instead, landlords or banks holding mortgages on the rental property would claim the credit.

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There are two fundamental reasons for this structure. First, the incomes of low income renters would likely be below the taxable income threshold and therefore not have tax liabilities against which to claim a tax credit. Second, even if the renters’ credit were structured as a refundable credit, individual renters would have to pay a higher, unaffordable rent during the year and only receive the refund annually. It is unlikely that low-income renters would be financially able to do so.

Structuring the tax credits so that they are claimed by property owners and banks solves these fundamental issues, but participants pointed out that it increases the complexity of the program and may dampen owner and bank participation. The participants discussed how to overcome these various issues, and the key points are summarized below.

*Property Owner Have Uneven Tax Liability*

As discussed above, the renters’ credit could be claimed by owners or by banks. Participants raised several concerns about the potential level of participation by property owners. Participants pointed out that the tax liability of property owners fluctuates from year to year. As a result, they may not find the credit that attractive. Participants suggested that the credit needs to be able to be syndicated to ameliorate this issue. Participants also suggested that the proposal add 5 year carry-back or carry-forward rules, as well as a partial refundability component. Additionally, the tax credit can be viewed as pro-cyclical in that its net benefit will decrease as the economy contracts, further deterring participation. CBPP suggested that the renters’ tax credit, however, has many tools to fight these concerns. Firstly, mortgage-providing entities, which usually have ample taxable income to ensure eligibility, can claim these credits and pass benefits onto owners through reduced mortgage payments. Additionally, states have the flexibility to strengthen the effect of the credit by increasing the credit amount as a percentage of the reduced rent.

*Future Subsidy Uncertainty*

The rental tax credit would require annual tenant eligibility recertification. This raised red flags for participants about the potential effect of the short-term aspect of these credits on owner and bank participation. Both banks and landlords would be subject to risks related to the uncertainty in a tenant’s income. Indeed the variability of the income stream could make banks less willing to participate as they may be uncomfortable underwriting reduced mortgage payments to owners. Similarly banks may be unwilling to underwrite new construction projects where owners plan to claim the renters’ tax credit. These issues are especially acute for smaller lenders. Finally, because the renters’ credit would be a new program, banks may be unwilling to account for it in their underwriting because the program itself may not be in existence for long.

In response to the first set of concerns, Ms. Sard emphasized that the program gives states the flexibility to provide multiple years of tax credits to owners or banks upfront, which should help allay fears. Participants suggested that the proposal should also allow smaller participant banks to form a consortium to spread out the risk associated with their participation. This will help balance unreliable cash flows. In response to concerns about the newness of the program itself and that it may not last long, Ms. Sard pointed out that tax programs have historically be less susceptible to cuts than domestic discretionary programs, which banks often incorporate into their underwriting.

*Accounting Standards*

The rental tax credit is structured to overcome eligibility issues arising from a landlord’s low taxable income by allowing mortgage providers to claim the credit. These banks would, in turn, pass the savings to the landlord via reduced interest payments. This process appears effective in practice, but
participants raised some potential roadblocks. Per IASB rules, banks account for mortgage transactions at the time of origination. This tax credit for reduced interest income tradeoff may have important accounting implications or may complicate the structure. As such, it was recommended that the Center for Budget and Policy Priorities meet with bank regulators.

Tenant Information Obstacles

While owners and banks would claim the credits and states could allocate the credits to them directly, states would also have the option of allocating credits directly to tenants. Tenants would then look for a landlord willing to claim the credit. Participants raised concerns that if credits were allocated to tenants, they would not have sufficient information about owners who would accept the credit. This could result in a low take-up rate among eligible households. Ms. Sard pointed out that states could allocate to owners and banks instead, who would be motivated to seek eligible renters. She also suggested that the program could require states to provide information to tenants on owners who would accept the credit.

Topic #2: Interaction with the LIHTC

A recurring theme of the roundtable was potential relationships between the proposed renters’ tax credit with the LIHTC program. CBPP’s proposal suggests that LIHTC and the renters’ tax credit should be distinct programs. Some participants however suggested promoting uniformity between the two programs to benefit from operational synergies. There could be overlapping compliance requirements between the two programs that could be streamlined if they were used in tandem such as rent calculations, waiting lists, and income certification. Others went further and suggested that the renters’ tax credit be targeted for exclusive use in LIHTC properties. Ms. Sard agreed that there could be administrative upside in mandating these credits at LIHTC properties, but also emphasized that the renters’ tax credit program aims to expand the range of living options and avoid concentrating tenants into certain properties.

Topic #3: Political Viability of Renters’ Tax Credit

Several participants expressed skepticism that reform of the tax code would yield any new support for low-income renters. Indeed, some participants were concerned that the renters’ tax credit could undermine support for LIHTC. In response, Ms. Sard emphasized that CBPP views the renters’ tax credit as a complement to the LIHTC, not as a competitor. Other participants opined that there may be a role for a subsidy to low-income renters as part of any distribution-neutral tax reform plan that incorporates other, regressive, changes to the tax system.

Other Issues Addressed

In addition to these overarching themes, a few other key areas were discussed, as follows:

New Program Justification

Related to the tax credit’s interaction with other federal programs, participants questioned the benefit of creating a new independent program, instead of expanding existing affordable housing tools. Ms. Sard spoke to the potential in creating a new program that can serve as a model for how to better administer housing programs than the current systems do. She argued that modeling change from outside the existing system has a greater probability of success than trying to force changes on the existing system. If successful, the administrative system for the renters’ tax credit could be converted into the existing infrastructure.
**State Allocation Preference**

As proposed, the tax credit would be allocated to the states, and the states would be responsible for distributing within their jurisdictions. There were questions about this allocation method, and some participants suggested mirroring the federal allocation method of the Community Development Block Grant or the HOME Investor Partnerships Program. Ms. Sard explained that they decided against this structure due to greater administrative costs stemming from increased complexities and higher number of administering jurisdictions. Additionally, state-administered allocation may promote synergies with LIHTC and other state-administered programs like Medicaid and Medicare.

**$5 Billion Allocation Target**

The initial phase of the program proposes a total allocation of $5 billion. Given the level of need among low-income households, this relatively low allocation number was questioned by several participants. Ms. Sard explained that $5 billion would offer a good starting point to help a substantial portion of low-income households in a meaningful way. CBPP thought a significantly larger number would be politically infeasible. She also suggested that it was prudent to start with a smaller program initially have it organically expand once its strengths are identified and weaknesses corrected.