Texas Competitive Low Income Housing Tax Credits

Texas City Attorneys Association
Summer Conference
June 13-15, 2018

Presented By:

Dean Roggia,
Senior Assistant City Attorney
City of Irving, Texas
825 W. Irving Blvd.
Irving, TX 75060
droggia@cityofirving.org
(972) 721-2541

I. Introduction

There are two types of low-income housing tax credits in Texas, the non-competitive four percent (4%) tax credit and the competitive nine percent (9%) tax credit. The purpose of this paper and the accompanying presentation is to provide helpful information to Texas municipal attorneys concerning requests for local government support in the context of the competitive nine percent (9%) low-income housing tax credit ("LIHTC"). Parts II and III of this paper will focus primarily on federal and Texas laws relating to LIHTC. Part III also discusses the adoption of rules by the Texas Department of Housing and Community Affairs ("TDHCA") found in the Texas Administrative Code ("TAC"). Part IV addresses the most recent United States Supreme Court case concerning the application of LIHTC rules adopted by TDHCA and disparate impact claims under the federal Fair Housing Act, as amended ("FHA"). Part V will address the challenges placed on Texas municipalities when asked to participate in the LIHTC program due to state law and the annual Qualified Allocation Plan ("QAP") criteria. Finally, Part VI summarizes key legal issues and offers suggestions when a municipality is asked to provide a resolution of support.

II. Internal Revenue Code Sec. 42

The federal housing tax credit program, created under Internal Revenue Code Sec. 42 ("IRC § 42"), is designed to encourage private developers to use private equity for the development of low-income rental housing. Under IRC § 42, housing tax credits provide a dollar for dollar reduction of federal income tax liability. The tax credit is applicable for a "credit period" of ten (10) years. I.R.C. § 42(f)(1). Ideally, the tax credit makes it feasible for private developers to provide a certain number of "low-income units" to

income qualified tenants. I.R.C. § 42(i)(3)(A). Without the federal tax credit program, a private low-income developer may not obtain sufficient rental income for a successful project, and private investors would have less incentive to provide any equity investment.[1]

To benefit from the tax credits, the developer must provide low-income housing subject to IRS requirements for an initial compliance period of fifteen (15) years. I.R.C. § 42(h)(6)(D). The tax credit may be reduced or recaptured by the IRS if the developer fails to satisfy the IRS requirements. *See* I.R.C. § 42(j). At the end of the compliance period, an "extended use period" begins for an additional fifteen (15) years subject to an agreement between the developer and the state housing credit agency. I.R.C. § 42(h)(6)(D). In Texas, TDHCA acts as the state housing credit agency and requires the developer to enter into a Land Use Restriction Agreement ("LURA") before tax credits are allocated.

Each calendar year, the IRS determines the state housing credit ceiling that will be allocated to TDHCA. I.R.C. § 42(h)(3)(C)(ii). For calendar year 2018, the state housing credit ceiling estimate in Texas was the greater of (1) $2.40 multiplied by the State population, or (2) $2,765,000 [Rev. Proc. 2017-58]. According to IRS Notice 2017-19, the estimated population figure for Texas was 27,862,596, which is multiplied by $2.40 for an estimated credit allocation amount of $66,870,230[2] for the 2018 LIHTC cycle. Ultimately, the number of credits awarded for a development is determined by

[1] The recent "Tax Cuts and Jobs Act" did not repeal IRC § 42; however, private developers appear to be concerned that the reduction in corporate tax rate will reduce the need companies may have for LIHTC.

[2] This estimate does not include any remaining or returned credits from 2017, or an updated population figure from the IRS, if any. According to TDHCA's website, the estimated total allocation for 2018 may be closer to $76,645,699.

calculating the proposed development's "qualified basis," which is a fraction representing the percentage of the project occupied by low-income residents multiplied by eligible costs. *Inclusive Communities Project, Inc. v. Texas Dep't of Hous. & Cmty. Affairs*, 747 F.3d 275, 277 (5th Cir. 2014), *aff'd and remanded*, 135 S. Ct. 2507 (2015).

III. Texas Gov't Code Ch. 2306

The Texas Department of Housing and Community Affairs ("TDHCA") is given specific authority to administer the tax credit program pursuant to Texas Gov't Code Ch. 2306. Specifically, Subchapter DD outlines the program objectives and allows TDHCA to adopt rules to meet those objectives while complying with IRC § 42.[3] The general purposes described in Subchapter DD are to encourage and preserve the construction and rehabilitation of low-income rental housing in the private marketplace. This includes a goal of providing for and encouraging for-profit and non-profit organizations to participate in the acquisition, development, and operation of affordable housing in both urban and rural communities. *See* Tex. Gov't Code § 2306.6701.

Chapter 2306 also outlines the statutory requirements for TDHCA's evaluation of applications for LIHTC. First, TDHCA evaluates whether the LIHTC application satisfies threshold criteria. *Id.* at § 2306.6710(a). Second, TDHCA scores and ranks the LIHTC application by a point system that prioritizes, in descending order, the listed statutory criteria. *Id.* at § 2306.6710(b). The selection criteria adopted by TDHCA in the QAP, discussed below, should be consistent with the statutory priorities. Along these lines, the Texas Attorney General has interpreted Chapter 2306 as an obligation and

[3] Tex. Gov't Code Sec. 2306.022 includes a sunset provision. Unless continued by law, TDHCA will be abolished September 1, 2025; however, IRC § 42 contains a special rule for states with constitutional home rule cities. That rule appears to allow home rule cities to administer the program.

limitation on TDHCA's ability to prioritize, rank, and score applications. Tex. Att'y Gen. Op. No. GA–0208 (2004). To satisfy these statutory goals and priorities, TDHCA adopts and regularly revises the rules found in Title 10, Chapters 10 and 11, of the Texas Administrative Code.

a. Title 10 Tex. Admin. Code Ch. 10 (Rules) and 11 (QAP)

Title 10, Chapter 10 of the Texas Administrative Code (entitled "Uniform Multifamily Rules") establishes the general rules relating to the award and allocation of LIHTC by TDHCA. Chapter 10 outlines the application process and establishes other elements of the tax credit program. In the context of a request for local government support, it's important to note that Chapter 10 establishes site and development requirements and restrictions. These are specific threshold rules that establish whether or not a proposed development location should receive funding or assistance from TDHCA in the first place. 10 Tex. Admin. Code § 10.101 (2018). If a developer is applying for LIHTC, the developer must disclose any undesirable neighborhood characteristics at the pre-application stage, and the developer may be required to show that those characteristics will be sufficiently mitigated. *Id.* To meet application deadlines, developers may request local government support even though many of the site and development requirements and restrictions remain outstanding. Accordingly, Chapter 10 is a good place to start in determining whether or not a particular request for government support from a developer should be taken seriously.

In addition to the rules established by Chapter 10, TDHCA establishes requirements relating to an award and allocation of LIHTC. I.R.C. § 42(m)(1). These requirements are codified in Title 10, Chapter 11 of the Texas Administrative Code,

which represents the Qualified Allocation Plan ("QAP"). At least biennially, TDHCA is required to adopt the QAP and a corresponding manual to provide information regarding the administration and eligibility for LIHTC. Tex. Gov't Code § 2306.67022. However, the QAP and manual are typically reviewed and revised annually after a project plan is drafted for public comment and discussion.

The QAP and corresponding manual outline the point system used by TDHCA for the award and allocation of LIHTC. Chapter 10 (Rules) and Chapter 11 (QAP) are so interconnected that TDHCA often uses the terms "Rules" and "QAP" interchangeably in its project plan. Along these lines, the 2018 QAP integrates Chapters 10 and 11 by explaining that all requirements in the QAP and all those applicable to LIHTC, or otherwise incorporated by reference in the QAP, collectively constitute the QAP required by Tex. Gov't Code § 2306.67022. *See also* 11 Tex. Admin. Code § 11.1. When reviewing a request for local government support, it's important to understand that the rules in Chapters 10 and 11 are revised often to reflect TDHCA housing policy, stakeholder comments, and other IRS and court rulings. Local governmental officials may participate in this process by providing public comment before the QAP and Rules are signed by the Governor and published in the Texas Register for codification in the Texas Administrative Code. *See* Tex. Gov't Code § 2306.0722.

IV. TDHCA v. Inclusive Communities Project, Inc.

In *Texas Dep't of Hous. & Cmty. Affairs v. Inclusive Communities Project, Inc.*, 135 S. Ct. 2507 (2015), a non-profit LIHTC developer, Inclusive Communities Project, Inc. ("ICP"), alleged that TDHCA's allocation of LIHTC discriminated against prospective tenants and buyers of real estate. Among other arguments, ICP made this

claim through a disparate impact theory under §§ 804(a) and 805(a) of the Fair Housing Act ("FHA") and supported its claim by showing the following statistical evidence: "From 1999–2008, TDHCA approved tax credits for 49.7% of proposed non-elderly units in 0% to 9.9% Caucasian areas, but only approved 37.4% of proposed non-elderly units in 90% to 100% Caucasian areas." *Inclusive Communities Project, Inc.,* 749 F. Supp. 2d at 499 (N.D. Tex. 2010). Further, "92.29% of LIHTC units in the City of Dallas were located in census tracts with less than 50% Caucasian residents." *Id.* The district court found that the statistical evidence was supported by other reports, including a HUD study, and a legislative report that concluded that, "TDHCA disproportionately allocated LIHTC funds to developments located in areas with above-average minority concentrations" and this practice led to "concentration problems." *Id.* at 500. Based on this evidence, the District Court agreed that a disparate impact claim was cognizable. TDHCA was allocating too many LIHTC to housing in predominantly black inner-city areas and too few in predominantly white suburban neighborhoods. *Inclusive Communities Project, Inc.*, 135 S. Ct. at 2510 (2015).

At the time of the District Court's decision, HUD had not yet adopted regulations regarding the three-step burden-shifting test for disparate impact claims under 24 C.F.R. § 100.500. Accordingly, the District Court applied the burdens of proof found in *Huntington Branch, N.A.A.C.P. v. Town of Huntington*, 844 F.2d 926, 928 (2d Cir. 1988), which required Defendants to (1) justify their actions with a compelling governmental interest and (2) prove that there were no less discriminatory alternatives. However, by the time the case reached the United States Court of Appeals for the 5th Circuit ("Fifth Circuit"), HUD's three-step burden-shifting test for disparate impact

claims had been adopted. Accordingly, the Fifth Circuit only found it necessary to reach one issue: "Whether the district court correctly found, that ICP proved a claim of violation of the Fair Housing Act based on disparate impact." *Inclusive Communities Project, Inc.*, 747 F.3d at 280 (5th Cir. 2014). In answering that issue, the Fifth Circuit adopted HUD's burden-shifting approach found in 24 C.F.R. § 100.500. The Fifth Circuit summarized that approach as follows:

> "First, a plaintiff must prove a prima facie case of discrimination by showing that a challenged practice causes a discriminatory effect, as defined by 24 C.F.R. § 100.500(a). 24 C.F.R. § 100.500(c)(1). If the plaintiff makes a prima facie case, the defendant must then prove 'that the challenged practice is necessary to achieve one or more substantial, legitimate, nondiscriminatory interests....' *Id.* § 100.500(c)(2). If the defendant meets its burden, the plaintiff must then show that the defendant's interests 'could be served by another practice that has a less discriminatory effect.' *Id.* § 100.500(c)(3)." *Id.* at 282.

The Fifth Circuit remanded the case for the District Court to apply HUD's new legal standard and TDHCA appealed to the U.S. Supreme Court. The U.S. Supreme Court did not ultimately decide the merits of ICP's claims, but held that disparate impact claims are cognizable under the FHA and remanded the case consistent with the Fifth Circuit's opinion. *Inclusive Communities Project, Inc.*, 135 S. Ct. at 2525 (2015).

V. Criteria Promoting Community Support

In *Inclusive Communities Project, Inc.*, the U.S. Supreme Court explains, "A plaintiff bringing a disparate-impact claim challenges practices that have a 'disproportionately adverse effect on minorities' and are otherwise unjustified by a legitimate rationale." *Id.* at 2513 (*emphasis added*). The focus on the word "practices" is an important factor to consider in the context of a city's role in the LIHTC process. In 2013, while TDHCA and ICP were engaged in litigation, Texas law was amended to prioritize, "quantifiable community participation…evaluated on the basis of a resolution

concerning the development that is voted on and adopted by…the governing body of a municipality in which the proposed development site is to be located." Tex. Gov't Code § 2306.6710(b)(1)(B) (*emphasis added).* Before this change in law, a request for city support would have come in the form of a commitment of development funding. For example, a developer would have earned 18 points by showing a total contribution from the city in the amount of $2,000 per low-income unit (QAP 2012-2013, p. 47). This commitment of funding represented a serious financial commitment by a city and it made it difficult for developers to earn maximum points without full city support. Likewise, the commitment of funding did not obligate cities to take any formal action, unless the city actually wanted to support the development. Developers would have found it difficult to argue that a city's refusal to provide development funding was a discriminatory practice.

a. Local Government Support

Under current law, priority is given to developers who can provide, among other things, a resolution of support from the governing body of a city. The 2018 QAP refers to this as "Local Government Support" and currently ascribes seventeen (17) points to an application if a developer can obtain a resolution expressly setting forth that the municipality supports the development. (QAP 2018, p. 28). TDHCA even provides a sample resolution on its website to help developers satisfy this scoring criteria. Unfortunately, the requirement for a resolution often places cities in the awkward position of being asked to support a development that doesn't meet the city's normal pre-development criteria or zoning code. This issue is complicated by the fact that final LIHTC application deadlines cannot be missed and the failure to secure seventeen (17)

points will be fatal to winning any LIHTC.

The competitive nature of this program further complicates the requirement to obtain a resolution of support. Developers are encouraged to submit pre-applications and self-score, which leads to a certain level of gamesmanship. Some pre-applications are filed and resolutions are requested for the purpose of gauging or scaring the competition. The result may be a request for a resolution by a developer who has no real intent to build in your city. To increase their chances of winning, developers may request multiple resolutions for the same property in one city, and multiple resolutions from multiple cities in the same region. Often, requests for a resolution in support are made before the developer has done any due diligence. Developers are required to show site control under the QAP, but they may not actually own the property. (QAP 2018, p. 17). Moreover, at the pre-application stage, developers may ask for a resolution of support, but they won't have development plans, environmental reports, impact studies, or even proper zoning.

In the meantime, the rules require the developer to send notice to the mayor and each member of the city council, neighborhood organizations, and several other local governmental officials. (QAP 2018, p. 18). In smaller cities, this notice may cause alarm among citizens and governmental officials who fear that infrastructure is inadequate or that schools and streets are already too crowded. The notice must disclose that in accordance with TDHCA's rules, "aspects of the Development may not yet have been determined or selected or may be subject to change, such as changes in the amenities ultimately selected and provided." (QAP 2018, p. 18). The informative value of this disclaimer may be of little worth to a governmental official charged with providing for

the public health, safety, and welfare and protecting the public fisc. Despite the obvious uncertainty surrounding the development, the developer must still ask for local government support, and the governing body of the municipality must make a decision under the risk of litigation.

Unfortunately, the request for support from a developer may even come with an FHA warning or a threat of litigation. TDHCA is certainly aware of the possibility of disparate impact and other FHA claims. Accordingly, the QAP includes the following statement concerning local government support:

> "In providing a resolution a municipality or county should consult its own staff and legal counsel as to whether such resolution will be consistent with Fair Housing laws as they may apply, including, as applicable, consistency with any Fair Housing Activity Statement-Texas ("FHAST") form on file, any current Analysis of Impediments to Fair Housing Choice, or any current plans such as one year action plans or five year consolidated plans for HUD block grant funds, such as HOME or CDBG funds." (https://www.tdhca.state.tx.us/multifamily/docs/18-QAP.pdf)

Given this warning, municipal attorneys should be familiar with the possibility of disparate impact, FHA claims, and other possible legal implications of the governing body's final resolution. According to QAP rules, a development can earn fourteen (14) points for a resolution expressly setting forth that the municipality has "no objection." (QAP 2018, p. 28). This appears to be a neutral stance, but given the competitive nature of the program, three points may be the difference between winning and losing. In more populated regions, a city may be faced with multiple applications, so the city will need to consider, as a matter of strategy, whether it is appropriate to treat all applicants the same. Of course, a city can pass a resolution of no support, resulting in zero (0) points. However, a resolution of this nature increases the likelihood of litigation under the FHA. After the application deadline has expired, TDHCA will publicly post a list showing all

city resolutions in support, no objection, or no support. According to the spreadsheet posted on TDHCA's website, 124 out of approximately 136 applicants obtained a resolution of support from a city in 2018. However, this number does not include the more than 400 pre-applicants that requested a resolution before withdrawing or being removed from LIHTC consideration.

b. Commitment of Development Funding

Experienced developers know the loss of one point can be fatal to an application. To earn one (1) additional point, a request for a resolution of support usually includes proof of a "Commitment of Development Funding." (QAP 2018, p. 29). This commitment requires affirmation of the city's monetary commitment to the development of the property. The commitment can be confirmed by letter, but developers generally add language to the resolution of support as a matter of convenience. The commitment can be in the form of a loan, grant, reduced fees, or contribution of other value that equals $500 or more for applications located in urban subregions. (QAP 2018, p. 29). The contribution is minimal, but a city that is already struggling to support a development will find any additional financial commitment hard to swallow. Not only is the city being asked to support a development before any pre-development standards or zoning codes are met, but the city is also being asked to provide funding support for the development.

c. Zoning

In addition to a resolution of support, a LIHTC developer must obtain a letter from the city's chief executive officer or zoning director (a) stating that current zoning supports the development; or (b) that "the applicant is in the process of seeking the appropriate zoning and has signed and provided to the political subdivision a release

agreeing to hold the political subdivision and all other parties harmless in the event that the appropriate zoning is denied." Tex. Gov't Code § 2306.6705 (5)(B). However, in the context of disparate impact claims, the release described above provides little consolation. Again, the LIHTC process may create a scenario where the city is being asked to provide a resolution of support before the developer goes through the zoning process. Does the developer really intend to hold the city harmless if zoning is denied? What will be the legal justification for a zoning denial when development support has already been given? The city can attempt to insulate itself by requiring the developer to fully indemnify the city in the case of a zoning denial, but the U.S. Supreme Court has given some guidance on how the Court may view this issue. "Unlawful practices include zoning laws and other housing restrictions that function unfairly to exclude minorities from certain neighborhoods without any sufficient justification. Suits targeting such practices reside at the heartland of disparate-impact liability." *Inclusive Communities Project, Inc.*, 135 S. Ct. 2521–22 (2015). Thus, it's unlikely that a state law or even a strong exculpatory provision would fully protect the city from a disparate-impact claim under the FHA.

VI. Conclusion

The LIHTC program administered by TDHCA involves a complicated legal process with many moving parts. To understand that process, it's important to become familiar with the laws and regulations governing the allocation of LIHTC. Local governmental support is a high priority in the program under Texas law. However, the state law establishing this priority does not take pre-development practices or city ordinances into consideration. Accordingly, cities are being approached by LIHTC

developers with a request for support that may conflict with city ordinances and development practices. In some cases, the request for support conflicts with policy decisions and public sentiment. In light of disparate-impact and other possible claims under the FHA; city practice, policy, ordinance, and public sentiment may not provide sufficient legal justification for rejecting a developer's request for support. Therefore, before a city takes action on a resolution for support, the city should consider whether the resolution violates federal law, and the possible impact such an action may have on the city's ability to receive state and federal funding. (QAP 2018, p. 28).