

The Low-Income Housing Tax Credit Program Goes Mainstream and Moves to the Suburbs

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Abstract

The Low-Income Housing Tax Credit (LIHTC) program is now 20 years old. With the maturing of the program, the use of tax credits has become commonplace in the development of rental housing across the nation. This article examines how the program has changed both financially and spatially. Specifically, the article asks whether it provides a mechanism that can help deconcentrate impoverished renters by providing access to low-poverty neighborhoods.

This research finds that as the price for tax credits rises, the program becomes increasingly popular with developers who are helping it make inroads in low-poverty suburbs. By entering the suburbs, the LIHTC program is meeting and even exceeding the performance of the Housing Choice Voucher Program in terms of offering opportunities to live in low-poverty settings.

Keywords: Housing assistance programs; Low-income housing; Poverty

Introduction

The Low-Income Housing Tax Credit (LIHTC) program is maturing. As it matures, it is changing the way it works both financially and spatially. The financial changes are helping to bring more money into low-income housing developments than was available before. This is making the program increasingly attractive to developers in markets that were previously underserved by housing assistance programs—namely, the low-poverty suburbs. More developers are using the program, thereby facilitating the entry of assisted housing into the suburbs at rates equal to or exceeding that of other programs specifically designed for that purpose.

This article begins with an examination of the price of tax credits over time. The price determines the contribution of tax credits toward the total

development costs of assisted rental units. This research confirms that tax credits are earning higher prices due to the lower risk associated with this form of investment. Reduced risk translates into increased syndication proceeds for LIHTC projects, thus making it easier for developers to obtain the financing they need to cover their remaining costs. Fewer and smaller loans and alternate subsidy programs need to be leveraged. Cities are faced with smaller requests for gap financing—all because tax credits are selling at higher prices.

The reduced risk is also associated with having developers more inclined to accept tax credits as a means of financing rental housing in locations that were previously resistant to subsidized housing. State housing finance agencies, the organizations that allocate tax credits among competing development proposals, are now awarding more credits to suburban developments than in the past. Given the high levels of financial support that credits provide at relatively low cost, developers are more willing to include LIHTC units in their suburban projects.

This research tracks the spatial distribution of LIHTC units over time and examines units in terms of their presence in central cities versus suburbs. Increasingly, LIHTC developments are found to have a greater presence in the suburbs. The program's penetration of the suburbs is compared with that of the Housing Choice Voucher Program (HCVP). This comparison offers insight into how well the two programs offer housing opportunities to low-income households. Do they grant access to better-off suburban communities that in the past have been notoriously resistant to accepting subsidized housing for the poor?

The article examines previous research on the LIHTC program, with attention given to the locational patterns of the program's units compared with other programs. This is followed by a review of the changes in the financial climate of the LIHTC program. The next section compares the locational patterns of LIHTC and HCVP units, noting the degree to which each program provides access to low-poverty neighborhoods. The article concludes with comments on the relative performance of these two approaches to providing housing subsidies and their potential to help very low income renters live in low-poverty areas.

Previous research

Deconcentrating poverty is a national goal, and housing programs for low-income renters are expected to work toward achieving it (Goering et al. 1995). However, few programs were designed with the specific objective of deconcentrating poverty. Rather, they were designed to address narrower housing goals

such as providing low-cost units or reducing the housing cost burden on low-income households. Over time, more was asked of housing programs. With these greater demands, programs were designed to achieve new goals, such as racial desegregation and economic self-sufficiency. (The Gautreaux program in Chicago is one example.) The notion of deconcentrating poverty evolved from these efforts (Goering et al. 1995).

Deconcentration of poverty means different things in different settings. It can mean locating households that come from all levels of the eligible low-income range within individual public housing projects, as the U.S. Department of Housing and Urban Development (HUD) now expects its public housing administrators to do. It can mean mixing low-income and middle-income households in newly redeveloped housing projects, such as those under the HOPE VI (Housing Opportunities for People Everywhere) program. It can also mean encouraging “families to locate in neighborhoods that will improve the life opportunities of family members” (Khadduri 2001, 69). It is this last approach to defining the term that is used in this article. Operationally, it means helping very low income households move to neighborhoods with low poverty levels. This concept derives from the work of Wilson (1987), who identified the harmful effects of concentrated poverty as exacerbating chronic joblessness, crime, delinquency, family breakups, and low academic performance.

Efforts to attack the problem are not always successful. Goetz (2003) describes in detail the workings of a poverty deconcentration effort in the Minneapolis–St. Paul area to illustrate the many problems inherent in making this idea work. The settlement of a lawsuit against the Minneapolis Public Housing Authority called for an aggressive plan for deconcentration and redevelopment. Many units in the inner city were to be demolished and would be replaced with new or renovated units elsewhere in the city and throughout the metropolitan area. What ensued was rapid demolition of the distressed public housing but slow construction of alternative housing in the form of fewer units than were demolished. In the suburbs, there was increased political opposition to the idea of developing public housing that would accommodate the poor from the inner city. Plans to redevelop the public housing sites for anyone other than the poor who had been displaced by the demolition led to political opposition in the inner city. The result was, in Goetz’s phrase, a political “race to the bottom” and an overly narrow response to concentrated poverty (2003, 252). If this is the outcome of an effort very specifically designed to address the problems of concentrated poverty, what outcomes can be expected from the more conventional rental housing production and housing assistance programs in use today?

The nation is engaged in many programs to help low-income renters. The two largest programs typify the two basic approaches to providing housing assistance—a production approach and a voucher approach. These approaches are viewed as the two sides of a competition, with each vying for predominance in national housing policy. In Winnick's (1995) estimation, the voucher approach has won. The LIHTC program is the production approach. The subsidy is attached to the unit, so it is described as project based. A low-income household can enjoy the subsidy only as long as it stays in the unit. If it moves, it loses the subsidy. The developer seeks out a location for the development, and if the agency allocating tax credits approves, the units are built. In effect, the developer and the government decide where the assisted housing is to be located.

The HCVP is the voucher approach. The subsidy is attached to the household, making it tenant based. The household finds a unit in the marketplace, and if the unit meets program rules for size, physical condition, and rent, then the subsidy can be used to help pay the rent. If the household moves, the voucher moves with it. The participating household chooses the neighborhood where it wants to reside but must do so within the constraints of the program and the marketplace. The landlord must be willing to accept a voucher as partial payment of rent, and many do not (Goering et al. 1995). Tight markets with few available units, especially few units with rents meeting program requirements, can inhibit choice (Basolo and Nguyen 2005). Finally, racial discrimination remains a problem since it seems to be behind the lower success rates of minority households seeking apartments (Basolo and Nguyen 2005; Varady and Walker 2003).

Both the voucher and the LIHTC programs were designed before deconcentration of poverty became a commonly used criterion for evaluating housing programs. Therefore, any failure to accomplish this goal cannot be attributed to a design flaw. However, since these are the nation's primary housing programs, it seems fair to ask to what extent they contribute to deconcentrating poverty.

The LIHTC program

The program was created in 1986 as part of the Tax Reform Act. Almost immediately, it was surrounded by controversy. Stegman (1991) pointed out that most developments needed many layers of subsidy beyond the tax credits to make them financially feasible. He found the program to be too complex and structured in an inherently flawed way. The poorer the households served, the greater the number of additional subsidy layers that had to be added, thus

increasing the complexity of the financing. He argued for a direct capital grant approach that could simplify the process and be structured such that the grants would be larger for those developments serving the poorest of the eligible low-income households.

Case (1991) argued that supply-side subsidies are generally inefficient, noting that there is stiff competition among developers for LIHTC subsidies. Asserting that this competition is *prima facie* evidence of an oversupply of the subsidy, he called for efforts to squeeze out the excess returns found in the program.

In examining the metropolitan markets where LIHTC units were being developed, Nelson (1994) found that these units were all too often being added in a price range where a surplus of units, rather than a shortage, already existed. Thus, the program was not always serving an unmet need and could actually be hurting particular market segments by adding units to already saturated markets.

Views of the program seem to have improved since then. Quercia, Rohe, and Levy (2000) prepared a follow-up to Stegman (1991), examining some of the same developments that he studied, plus others. In particular, they addressed the performance of LIHTC developments sponsored by nonprofits. With a sample of 36 developments, they found that despite the complex financing and many layers of subsidy, the projects were financially viable and in good physical shape. The creative financing criticized by Stegman (1991) was found to have a few advantages in that it brought about long-term partnerships, typically between community-based nonprofits and developers. However, Quercia, Rohe, and Levy (2000) found a need for greater public acceptance of LIHTC developments and suggested that greater recognition of the role played by nonprofits is required. With time, reviews of the LIHTC program found it to be both flexible and cost-effective (Cummings and DiPasquale 1999; McClure 2000). The program is flexible in that it can work with many types of housing units in locations offering very different market conditions. It has become more cost-effective in that each tax credit dollar is producing more housing as the program matures. The yields to investors in tax credits have fallen, producing more funds for the projects, and the funds are going into projects with less diverted into fees.

The LIHTC program is now the “principal federal subsidy mechanism for supporting the production of new and rehabilitated rental housing for low-income households” (HUD 2005c, 5). The program is healthy and produces about 1,300 projects and 91,000 units per year. Occupancy levels are good at 95 percent, compared with 90 percent for rental housing nationally (“E&Y Confirms Positive Returns” 2004; Joint Center for Housing Studies 2005).

Projects are generating high levels of net operating income relative to loan obligations. The vast majority of these developments are producing positive cash flows annually, and the foreclosure rate is extremely low at 0.01 percent (“E&Y Confirms Positive Returns” 2004).

The LIHTC program is not designed to directly serve the poorest of the poor. It serves households with incomes below 60 percent of the area median family income (AMFI), although the owner may choose to serve only those with incomes under 50 percent. LIHTC developments usually charge rents that are at or close to the maximum permitted by the program. The rents are not tied to the household’s income. Rather, units are leased only to eligible households with enough income to afford the rent. A study of LIHTC developments found that resident households that did not receive vouchers or other rental assistance subsidy had incomes placing them at 45 percent of the AMFI (Ernst & Young LLP, Kenneth Leventhal Real Estate Group, 1997). By comparison, among HCVP households, the average income is 22 percent of the AMFI (McClure 2005).

Critics of the LIHTC program call on it to play a larger role in providing mixed-income housing (American Bankers Association et al. 2004; Freeman 2004). The program was initially viewed as a mechanism to cause a fraction of the units in a development to be set aside for households whose income was less than 60 percent of the AMFI. The tax credit rules call for a minimum of 20 percent of units to be set aside for those whose income is less than 50 percent of the AMFI or 40 percent of the units for those whose income is less than 60 percent of the AMFI. If the goal was to develop mixed-income housing, then setting minimums may have been the wrong approach. Some 84 percent of LIHTC developments placed in service through 2002 have tax credits applied to all units (HUD 2005c). With nearly all LIHTC units located in developments occupied entirely by households whose incomes are less than 60 percent of the AMFI, there is very little income mixing within the developments; the residents are all very low income. There can be some income mixing at the neighborhood level if these developments are located where household incomes are higher and there is little or no concentrated poverty.

The location of assisted housing developments remains a problem. Despite the best of intentions, project-based assisted housing for the poor is all too often located in neighborhoods with low-priced homes and high concentrations of the poor and minorities (Rohe and Freeman 2001). Newman and Schnare (1997) compared the characteristics of neighborhoods where project-based developments are sited with those of other renter households. They concluded that project-based programs do little to improve the quality of the assisted household’s neighborhood and that public housing actually makes

things worse. Compared with all rental units, units in assisted project-based developments are significantly more concentrated in lower-income neighborhoods. Thus, project-based housing programs have not contributed to reducing concentrations of poverty or racial minorities; in fact, they appear to have exacerbated the problem.

Freeman (2004) examined the issue of income mixing by comparing LIHTC units with other project-based developments. He determined the proportion of units located in the suburbs and the characteristics of the neighborhoods where they are located. His research compares the nation's current production program, the LIHTC program, with former production programs including public housing, Section 8 New Construction and Substantial Rehabilitation, and various below-market interest rate programs. He found that LIHTC units are disproportionately located in the suburbs and suggested that the capacity to penetrate the suburbs is due, at least in part, to fewer political constraints on these developments. The LIHTC program seems to be more acceptable to suburban communities than its predecessor project-based programs. Freeman (2004) also found that LIHTC units are located in neighborhoods where the incidence of poverty is higher than it is for the population as a whole. However, those LIHTC units that did locate in the suburbs were sited in neighborhoods with higher median incomes and lower levels of poverty than the central-city neighborhoods where other LIHTC units were located. Freeman states, "Taken together, then, the results...tell a consistent story. LIHTC neighborhoods are not as economically disadvantaged as those with traditional federally assisted housing developments" (2004, 9).

Voucher programs

The government is also concerned with the location of HCVP households. While the intent of the program is to give the tenant free choice on where to live, there is concern that free choice has not resulted in improved neighborhood conditions. Newman and Schnare (1997) examined the neighborhood outcomes of holders of Section 8 certificates and vouchers, the precursors of the HCVP. They found that certificate and voucher holders were only a little more likely to live in middle-income neighborhoods than the average welfare recipient and slightly less likely to live in such areas than the average resident of a privately owned, project-based assisted development.

Efforts to improve neighborhood outcomes for voucher holders have been undertaken. The standard HCVP implementation provides participating households with very little counseling. In most cities, the counseling is hardly more than instruction on program rules. The Moving to Opportunity (MTO)

program was designed to encourage voucher households to move to low-poverty neighborhoods. It included a counseling component along with some requirements to guide voucher holders to neighborhoods with lower concentrations of poverty and racial minorities. The MTO program was a carefully designed experiment comparing three groups of households. One group stayed in public housing. Members of another group, known as the Section 8 group, were given vouchers with no restriction on where they could live, while members of a third group, known as the experimental group, were given vouchers that could only be used in tracts where less than 10 percent of the population were below poverty level in 1990 (Orr et al. 2003). Only 47 percent of the households in the experimental group were able to successfully lease a unit, compared with 62 percent in the Section 8 group. Thus, the requirement to locate in a low-poverty tract proved to be a difficult hurdle, with more than half of the experimental group unable to find a unit, although many did manage to find a unit in a tract with only marginally higher poverty. Among those households that were able to lease a unit, only 11 percent of the Section 8 group located in low-poverty tracts while 89 percent of the experimental group did so.¹ Thus, of all households in the experimental group, only 42 percent managed to locate in low-poverty tracts (89 percent of the 47 percent who succeeded in leasing a unit).

Devine et al. (2002) examined the locational patterns of all HCVP households in the 50 largest metropolitan areas and found that about 28 percent of all voucher holders located in low-poverty tracts (less than 10 percent poverty). This performance falls well short of the 89 percent realized with the MTO program, thus indicating that gains can be realized if moving to a low-poverty neighborhood is made a program requirement.

Experience with the HCVP in general, and the MTO experiment in particular, suggests that it is very hard to use vouchers as a tool to deconcentrate poverty. As it is normally implemented, the HCVP will place, at best, only about one in four households in low-poverty tracts. With the added push of intensive counseling and a concerted effort to require this move, most who find a unit will succeed in locating in a low-poverty neighborhood, but with a dramatic drop in the rate of finding units at all. This leads to the central question for this research: How do the LIHTC program and the HCVP compare in terms of performance? Is the LIHTC program better or worse at locating units in low-poverty tracts than the HCVP?

¹ Waivers were granted to some households in the experimental group. In other cases, households in the experimental group moved into a low-poverty neighborhood only to see its poverty level rise.

Approach and methodology

This research uses the national database of LIHTC units to identify the developments by location (census tract) and first year of occupancy (HUD 2005c). For those developments located in metropolitan areas, the analysis categorizes the locations by central city versus suburbs.

This research joins the LIHTC data with data on the HCVP that HUD has made available from its Multifamily Tenant Characteristics System.² These data are also coded at the census-tract level. The LIHTC data cover developments placed in service from 1987 through 2002. The HCVP data are for fiscal year (FY) 2002.

The LIHTC data are limited in that a significant percentage of the units could not be geocoded by HUD. For some developments, the address was incorrect or incomplete and could not be matched to addresses in HUD's geographic information system. The tax credit data describe 22,361 developments with 1,141,650 units. However, geographic location is known for only 20,123 projects with 956,207 units. Thus, about 10 percent of the projects and 16 percent of the units are missing. A sample of 90 to 84 percent of the universe is normally extremely good. However, there may be bias if the missing projects and the reported projects are not similarly distributed. Climaco et al. (2006) indicate that the projects developed in the early years of the program were more likely to be missing from the database, which had very high reporting accuracy in later years. It is possible that developments awarded tax credits in the early years (pre-1995) were less likely to be in low-poverty tracts because of the tendency to merge LIHTC subsidies with Section 8 Moderate Rehabilitation subsidy funds. Because of the possible bias, the results from this research must carry a cautionary note. However, projects built since the mid-1990s are the more interesting because this is when researchers and policy makers began to focus greater attention on alleviating concentrated poverty.

Similarly, the FY 2002 HCVP data also suffer from some underreporting. The data describe about 1.2 million households out of an estimated 1.5 million authorized vouchers. It is not clear how many of the authorized vouchers were simply not in place with a household and how many were in place but not reported. Given the broad scale of the aggregation and analysis in this research, however, it is doubtful that the missing data could be so different as to alter the results significantly.

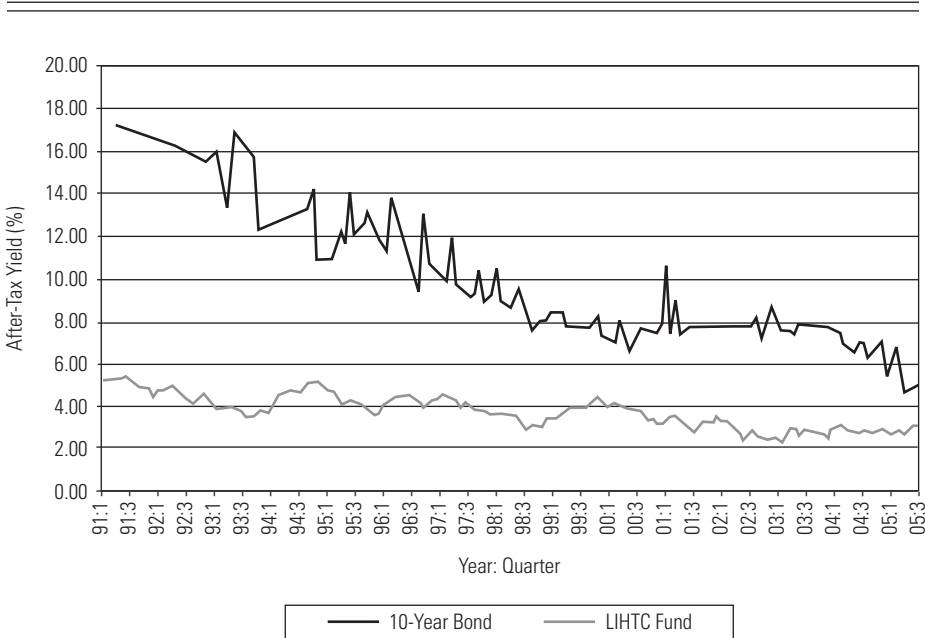
² HUD's Office of Policy Development and Research prepared this data set in 2003. It contains proprietary data assembled for research purposes and is not published.

Changes in the financial climate for tax credits

The risk associated with investing in tax credits has fallen over time. Smith (2002) assesses the risk of investing in tax credits, comparing the yields on investment funds that specialize in LIHTC developments with the yield on government bonds. Risk is the total return on investment minus the effects of inflation and the true, risk-free, return on investment. Since LIHTC developments are viewed as long-term investments, the best measure of the inflation- and risk-free return is found in the after-tax yield on the federal government's 10-year bonds. Thus, the difference between the yield on LIHTC funds and the 10-year bond after-tax yield identifies the risk associated with investing in LIHTC developments. This figure has fallen rapidly over the life of the program. (See figure 1.)

In the early years of the program, tax credit investors realized a return of 15 to 17 percent. This corresponds to paying about 45 cents for each dollar of tax credit promised over the first 10 years a development is occupied. During these initial years of the LIHTC program, the after-tax bond yield was 4 to 5 percent, indicating that investors associated investment in tax credits with a

Figure 1. Historical Institutional Tax Credit Fund Yields and the 10-Year U.S. Bond Yield after Taxes



Source: Ernst & Young LLP, Tax Credit Investment Advisory Services 2005.

level of risk of 11 to 12 percentage points or approximately the level of risk associated with investing in the stock market, which is deemed to be a relatively risky venture.

As the LIHTC program matured, the yield fell, as did the bond yield. By the mid-1990s, the tax credit yield had fallen to less than 15 percent and by 1997 had moved steadily toward 10 percent. The bond yield fell much more slowly, dipping below 4 percent by 1996. Thus, the spread between the tax credit yield and the bond yield fell from 10 percentage points in 1993 to only 5 percentage points by 1997. By 2005, the gap between the yield in tax credit funds and U.S. Treasury bonds fell to only 2 percentage points. In effect, investors viewed low-income housing tax credits as a very low risk investment. With the yield on tax credit funds at a mere 5 percent, investors were paying 80 cents and more per dollar of tax credit. Since the spread between 10-year bonds and tax credits funds is so low, it is not clear that this can be sustained. Because tax credit properties are performing well (they have strong occupancy rates and extremely low foreclosure rates), the market will accept a very small risk premium on tax credit funds. However, this low yield is causing concern in investment markets, and the trade literature is talking of a correction that will force yields on tax credits to move higher (Kimura 2005).

During this same period, the tax credit investor changed form. Investors are increasingly corporations rather than individuals (Smith 2002). Real estate lenders are normally concerned that the owners have significant equity interest in a property. The primary lender wants to know that the owners have an incentive to stay with a development, to protect its value, and not to abandon it if the market turns. The primary lender also wants to have owners who can be called on to make a contribution to the development if new investment is needed to avoid default and foreclosure. In other words, lenders want to be able to force investor-owners to make contributions toward working out a failed loan.

The lower risk incorporated into the current pricing of tax credits reflects a belief by corporate investors that they are shielded from the risk of further contributions in the event of failure. For an investor, buying tax credits is little different from buying any other security. The down side for investors is that the credit could lose its value if the development fails, but the up side is that the owners of tax credits are no longer viewed as investor-owners as they were in the past.

The ownership's managing general partner has the burden of making the development successful. The money contributed by the purchasers of the tax credits has become little different from any other source of financing. As long as the primary lender stands in a superior position to claim the property in case

of foreclosure, investors are no longer expected to have any more than a passive financial interest in the property. In effect, the proceeds from tax credits are less an owner's equity contribution and more a form of subordinate loan.

For state and local housing planners, this process has been a mixed blessing. There have been some losses, such as the reduced role of the tax credit purchaser as an owner, but the gains are very large.

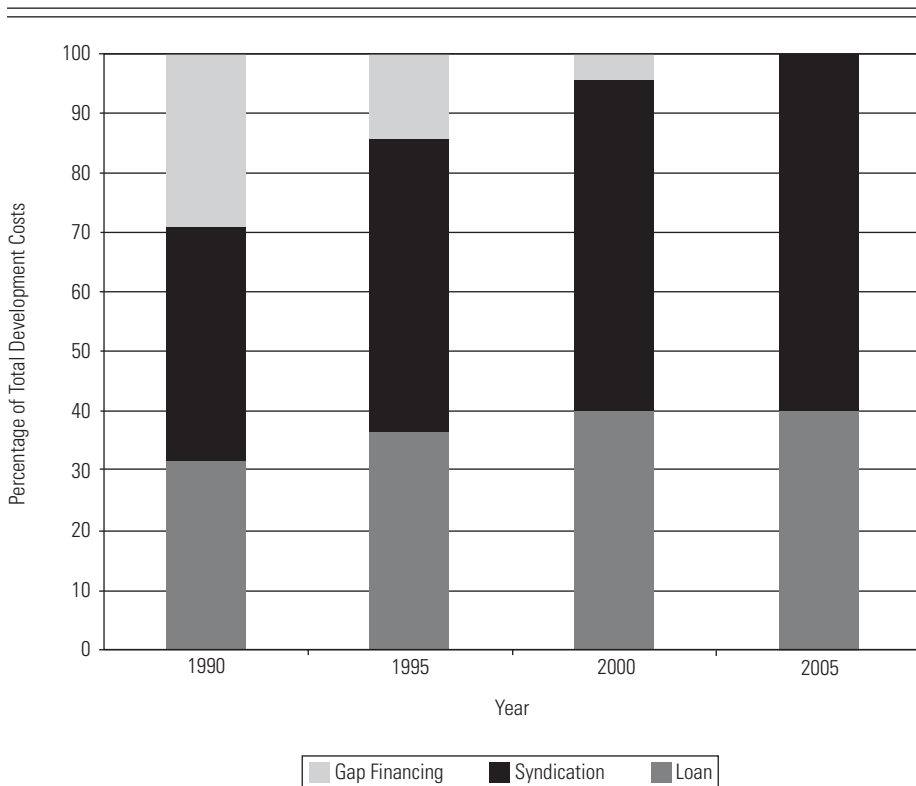
The public sector is often expected to provide gap financing to LIHTC developments. The gap is the difference between the total amount of money needed to develop a project (both the hard construction costs and the soft development costs) and the amount of available financing. The need for this additional subsidy has been common over the life of the LIHTC program. Abravanel and Johnson (2000) examined a sample of LIHTC projects developed during the 1990s and found that 74 percent of them had some form of gap financing over and above a market-rate loan and the proceeds from the sale of tax credits.

Financing typically comes from one or more lenders, from the sale of tax credits, from direct contributions by the owners, and from additional subsidy programs, such as the HOME program. The amount that a lender has been willing to loan to a development is based on the level of income the project generates after expenses. Understandably, lenders are willing to loan a smaller percentage of the total costs for a LIHTC development than for a market-rate one because of the reduced rents the LIHTC development can charge. While rents for these developments have increased over time, so have expenses, and there has not been any significant shift in the percentage of project costs that can be covered by loans. Nor has there been any significant shift in owners' willingness to make large, up-front equity contributions to a development.

Given the limitations on rents that reduce the income to LIHTC developments and most especially the limitations on the sale of these developments, investors are unwilling to provide direct equity, except in exchange for tax credits (McClure 2000). However, with the reduction in the risk assessment applied to investing in tax credits, the amount that investors are paying toward total investment costs has risen significantly. Selling tax credits at 45 cents on the dollar generated a small contribution toward total development costs that left most projects with a significant gap needing to be covered, usually by the public sector. Selling tax credits at 80 cents on the dollar generates a large contribution toward development costs, reducing—or even eliminating—the need for gap financing. Thus, part of the benefit of a lower risk associated with tax credits is simply more money to cover development costs, thereby reducing the need for other subsidy programs to cover the gap.

Figure 2 illustrates the amount of gap financing needed to develop a typical LIHTC project at various times over the history of the program. These figures are taken from a sample of LIHTC developments that were being financed in the Midwest in 2005. While the developments reflect local market conditions, their size, development costs, and financing terms make them comparable to LIHTC projects being developed across the nation. Each of the projects in the 2005 sample was able to cover all development costs through conventional mortgage loans and syndication of the tax credits; no gap financing was needed. In fact, the governing housing finance agency did not even provide the full amount of tax credits for which the developments were eligible. When the loan that can be leveraged is subtracted from the total development costs, the remainder is smaller than the proceeds that can be obtained from the sale of the tax credits. To prevent a surplus benefit to the developer,

Figure 2. Sources of Financing for a Typical LIHTC Project



Source: Derived from proprietary, unpublished data on the costs and financing of LIHTC developments provided to the author by US Bank's Community Development Corporation in 2005.

the allocating agency lowers the amount of tax credits awarded to the project to the amount that will provide exactly enough to cover the remaining development costs. This means that these developments need no gap financing.

While this case is common today, it is not true for all markets, nor has it been true for the life of the program. In many markets, development costs are extremely high relative to rents. In these cases, even with the awarding of the maximum allowable tax credits, a financing gap remains, and the public sector is generally called on to cover this gap through a subsidy program layered on top of the LIHTC program.

Figure 2 also applies the 2005 sample to earlier years by using the credit pricing and mortgage terms found then to estimate what lenders would have provided for debt financing and what investors would have paid for the tax credits offered. As figure 2 illustrates, gaps of about 5 percent were common in 2000, down from over 25 percent in 1990. As the need for gap financing decreases, state and local governments gain in that there are fewer demands on scarce resources. Funds can be directed toward the few developments that cannot be made feasible without gap financing or toward other affordable housing initiatives.

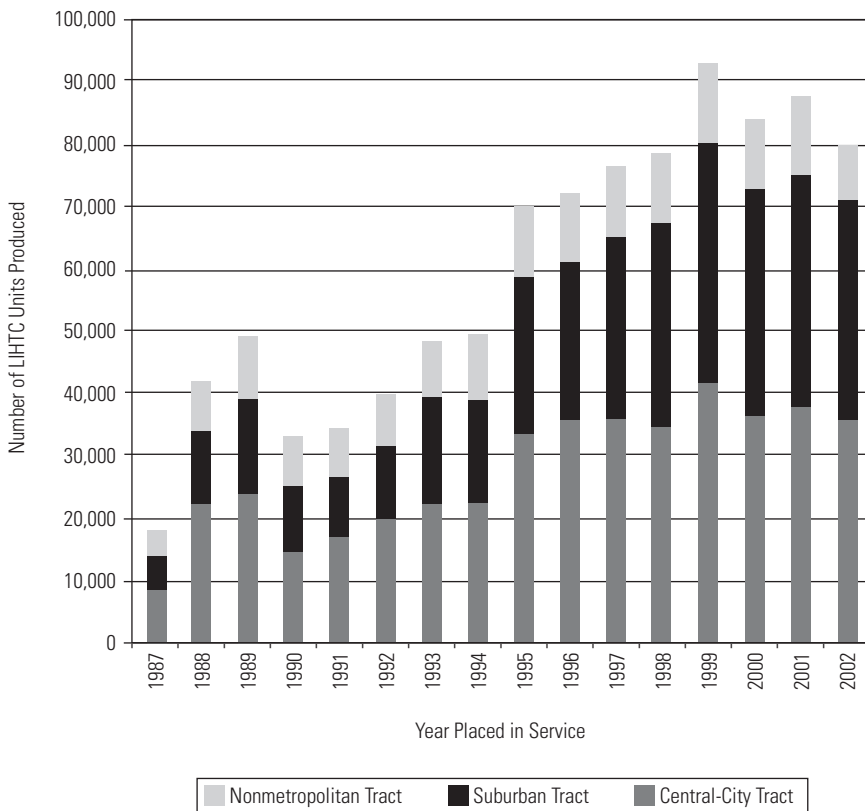
In addition to a reduced need for gap financing, there is another gain from the maturation of the LIHTC program. Its appeal to developers is broadening.

When the program was initiated, the benefits were minimal for a developer who chose to participate. They were often not enough to make the project financially feasible. The developer had to accept reduced rents on those units given tax credits but gained little in return. Each credit sold would generate only 45 cents, a relatively small amount relative to the loss of income (McClure 1990). Almost two decades later, the trade-off has improved. Each dollar of tax credit sold is generating around 80 cents. In addition, the cost of raising these funds has been reduced. As the program has matured, the fees associated with the sale of tax credits have fallen (McClure 2000). The LIHTC program has become a very low cost source of financing. Thus, in exchange for lowering rents, a developer can get over 80 cents per dollar of tax credit sold. A developer who searches carefully can find many markets where the rents permitted under the LIHTC program are little different from unsubsidized rents. The deal is then just too good to pass up. Prior objections to working in assisted housing are being dropped. Using the LIHTC program helps developers meet the inclusionary zoning and fair-share housing set-aside requirements that are becoming common in many locales. Low-income housing tax credits are becoming mainstream; they are moving to the suburbs.

Changes in the spatial location of LIHTC units

To give a sense of the scale of the program, figure 3 examines the number of units produced per year by location in central cities, suburbs, or non-metropolitan census tracts. The rapid growth in production during the first three years of the program probably reflects projects that were planned during the early or mid-1980s with assistance anticipated from one of the older project-based housing subsidy programs. These programs were discontinued, but the planned projects were adapted to the new tax credit program. Once this pipeline of projects was exhausted, the development community had to adjust to the demands of the new tax credit program. Therefore, 1990 may reflect the real start of the program with projects specifically designed for the use of low-income housing tax credits. After that start, the industry was able to increase its output each year throughout the 1990s.

Figure 3. LIHTC Units by Location and Year Placed in Service



Source: HUD 2005b.

While there was some reduction in the number of units produced from 2000 through 2003, it was not a drastic cutback. During these years, between 80,000 and 87,000 units were produced annually. If production continues at this level, in a few short years the LIHTC program will become the nation's largest form of housing assistance for low-income renters, becoming larger than the stock of either public housing or the HCVP.

The spatial distribution of LIHTC units reflects the increasing acceptance of the program. Production in rural areas has remained generally steady at 9,000 to 12,000 units annually from 1992 through 2002. Production in the central city is also generally steady, though on a much larger scale. Central-city production has been between 33,000 and 37,000 units annually with one spike to 41,000 units in 1999. It is in the suburbs that a pattern of growth is found. During the early 1990s, only 9,000 to 11,000 units were placed in suburban locations. During the mid-1990s, this grew to 17,000 to 29,000 units per year. However, during the late 1990s and into the new millennium, production has reached rough parity with the central cities at 33,000 to 39,000. Suburban production is up three- to fourfold over the life of the program.

The total share of LIHTC units in the suburbs may rise even more in the next few years. In the early years of the program, LIHTC developments had to commit to only 15 years of low-income occupancy, with possible transfer to market-rate housing after that. Since the developments that were awarded subsidies in the early years of the program were disproportionately in the central cities, it is likely that these are the developments that will be lost from the low-income housing stock as they reach their 15th year of operation.

Comparing the LIHTC program with the HCVP

The two programs place comparable shares of units in the suburbs. By 2002, the LIHTC program had located 38 percent of all units placed in service from 1987 through 2003 in the suburbs. This slightly outpaces the FY 2002 distribution for the HCVP (35 percent) and falls just below the 39 percent for all rental units. The LIHTC and voucher programs were also providing comparable numbers of units to the suburbs. By 2002, the LIHTC program assisted about 359,000 units in suburban tracts while the HCVP assisted about 423,000 units. Combined, these assisted units comprise about 5 percent of the 14.9 million rental units found in the suburbs by the 2000 census (U.S. Bureau of the Census 2005).

Deconcentration of poverty

If both programs are making comparable entry into the suburbs, how do they compare in terms of the poverty level in the neighborhoods where their households are located? Table 1 lists the incidence of poverty across the programs, broken down by location. For purposes of comparison, table 1 lists the average percentage of tract poverty for several different populations, reflecting the different populations served by the HCVP and the LIHTC program. The former tends to serve households whose income is below the poverty level, so table 1 lists the average tract poverty for renter households living below poverty level. The LIHTC program tends to serve households that have very low incomes (less than 50 percent of the AMFI), so table 1 also lists the average tract poverty for very low income renter households.

Table 1. Average Percentage of the Population below Poverty Level in Tracts by Metropolitan Location for LIHTC and HCVP Units, Renters, and Households

Tract Location	LIHTC Units	HCVP Households	Renter Households below Poverty Level	Very Low Income Renter Households	All Renter Households	All Households
Suburbs	12.5	13.5	15.1	12.1	10.7	8.2
Central city	26.0	23.2	27.4	24.4	20.5	16.9
Nonmetropolitan area	16.7	17.9	19.9	19.9	16.3	14.5
All tracts	19.4	18.9	22.3	19.8	16.0	12.2

Source: HUD 2005a and 2005b, U.S. Bureau of the Census 2005, and HUD's confidential data set on HCVP households. (See footnote 2.)

Both programs place households in neighborhoods with a higher incidence of poverty than would be expected given the incidence of poverty in the population as a whole or the incidence of poverty among all renter households. Both place households in tracts with about 19 percent poverty, which is higher than the 16 percent found among all renters and the 12 percent found in the total population. However, the average poverty surrounding program units is below the 22 percent found for all renters living below poverty level and the 20 percent for all renters with very low incomes. This suggests that there is some use of housing assistance to move to neighborhoods with a lower incidence of poverty.

The LIHTC units in the suburbs are generally located in neighborhoods where the incidence of poverty is lower than is typical for all renters and is

comparable to that found in the population as a whole. For example, any household can expect that 12 percent of its neighbors (1 in 8) will be below the poverty line. But poverty is not evenly distributed, nor is rental housing. A typical renter can expect that 16 percent of the neighbors (1 in 6) will live below the poverty line, but that number rises to 21 percent (1 in 5) for a typical central-city renter. However, the LIHTC program has made entry into the suburbs such that the typical household in a suburban LIHTC unit can expect that 13 percent of its neighbors (1 in 8) are below the poverty line. HCVP households in the suburbs are performing nearly as well at 14 percent. With either program—project-based tax credit units or tenant-based vouchers—the use of housing assistance in the suburbs is likely to help a household locate in a setting with less poverty than is found among renters as a whole, all very low income renters, or all renters living below the poverty line.

It appears that the nation's two primary housing assistance programs enjoy some success in facilitating access to suburban neighborhoods where the poverty level is generally low. However, the incidence of poverty in a tract tells only part of the story.

The effects of poverty on a neighborhood seem to be nonlinear; that is, they have threshold effects. For policy purposes, it is important to know not just the incidence of poverty within a district, but whether the neighborhood falls above or below a certain threshold. Galster (2005) describes the impact of poverty as having two thresholds. The lower threshold is found at 10 percent to 15 percent poverty. Below this threshold, the negative effect of poverty on the neighborhood is negligible. Above this threshold, each additional increment of poverty increases the negative effect on the neighborhood. However, there is a second threshold at about 40 percent. As poverty increases up to this second threshold, the negative effect increases, but moving above this threshold seems to carry no additional impact. The damaging effect of concentrated poverty has reached its maximum.

Galster (2005) stresses that the programs designed to deconcentrate the poor have focused too narrowly on improving the neighborhood conditions of the assisted household. He argues that housing programs should also pay careful attention to the impact of assisted housing on the receiving neighborhoods. Programs to deconcentrate the poor should assess both the potential gains to the assisted household and the potential harm to the receiving neighborhood. If the number of assisted households moving into the receiving neighborhood does not push the neighborhood above the lower threshold, then it can be assumed that placing these households has no measurable negative effect. If the number of assisted households does push the neighborhood above the lower threshold, or if the neighborhood was already above the lower threshold before

additional assisted households moved in, then it can be assumed that the neighborhood is harmed. It would appear that a well-designed housing assistance program, whether project based or tenant based, should not generate significant negative consequences for the receiving neighborhood.

Table 2 examines all tracts broken down so as to approximate these categories of concentrated poverty. It compares the LIHTC and voucher programs

Table 2. Percentage of Units by Poverty Concentration Category for LIHTC and HCVP Units, Renters, and Households

Tract Location	LIHTC Units	HCVP Households	Renter Households below Poverty Level	Very Low Income Renter Households	All Renter Households	All Households
Suburbs						
Low poverty (< 10 percent)	50.1	43.1	39.4	48.5	59.3	72.7
Moderate poverty (10 to 40 percent)	48.2	55.4	57.1	49.4	39.6	26.8
High poverty (> 40 percent)	1.7	1.5	3.5	2.1	1.1	0.5
Central city						
Low poverty (< 10 percent)	13.7	13.6	11.1	14.9	25.4	37.2
Moderate poverty (10 to 40 percent)	70.2	76.8	69.6	69.6	65.0	56.8
High poverty (> 40 percent)	16.1	9.6	19.3	15.3	9.5	6.0
Nonmetropolitan						
Low poverty (< 10 percent)	24.8	18.7	15.3	20.9	26.7	32.8
Moderate poverty (10 to 40 percent)	72.8	78.5	79.2	75.0	70.6	65.8
High poverty (> 40 percent)	2.4	2.9	5.5	4.1	2.7	1.4
All tracts						
Low poverty (< 10 percent)	29.2	24.8	20.2	27.4	38.9	53.6
Moderate poverty (10 to 40 percent)	62.4	69.5	67.8	63.6	55.9	44.0
High poverty (> 40 percent)	8.5	5.7	12.0	9.0	5.2	2.4

Source: HUD 2005a and 2005c, U.S. Bureau of the Census 2005, and HUD's confidential data set on HCVP households. (See footnote 2.)

in terms of their capacity to locate households where they will enjoy a lower incidence of poverty.

Over half of all households (54 percent) live in low-poverty areas, but only about a third of all renters do. Neither program can locate assisted households in low-poverty tracts at anything approaching these levels. The HCVP can locate only 25 percent of its households in these low-poverty areas, but this is about 5 percentage points higher than the 20 percent of renter households that live below poverty and can locate in low-poverty areas. The LIHTC program performs better, placing 29 percent of its units in low-poverty tracts, but this is only 2 percentage points better than the 27 percent of very low income renters living in low-poverty tracts.

Only a very small percentage of the total population—about 2 percent of all households—lives in high-poverty neighborhoods, that is, tracts where poverty exceeds 40 percent. However, about 12 percent of all renters with incomes below the poverty line and 9 percent of all very low income renters live in these neighborhoods. Both programs are found in these high-poverty tracts at rates lower than these comparison groups, indicating that these programs provide a vehicle for some deconcentration of the poor.

Both programs are designed to serve low-income households, although the HCVP serves a poorer segment. This program offers choice of location. Given this freedom of choice, some households may opt to live in neighborhoods that contain very poor populations. The household may find such a location familiar and, therefore, desirable. It may offer close proximity to family or other social contacts or easy access to various social service delivery systems that might not be nearby if the household moves to a neighborhood with a lower level of poverty (Varady and Walker 2003).

The LIHTC program has been used as part of various neighborhood revitalization initiatives. These efforts often involve the production of new housing units or the renovation of existing buildings in neighborhoods where the population is very poor. The objective is to stabilize the neighborhood and offer good-quality housing where little is available. Therefore, locating the LIHTC units here would be unlikely to serve the goal of deconcentrating poverty. It is possible that LIHTC units might attract the eligible low-income population with the highest incomes to this neighborhood and reduce the dominance of those living below the poverty line. However, the opposite is possible as well. The LIHTC units could attract households struggling to stay out of poverty and, if the units are located in high-poverty areas, could serve to further concentrate poor households. It is important to note that 16 percent of the LIHTC units built in central cities are located in high-poverty neighborhoods. This is almost twice the incidence found in the renter population.

The HCVP finds 10 percent of its central-city households locating in high-poverty tracts. If this represents an underlying level of attraction to high-poverty neighborhoods, then the 16 percent placement of LIHTC units into these tracts is an increase of about 6 percentage points. This higher level of placement can make sense if these units are revitalizing the neighborhood. It can be a mistake if these units serve to further concentrate poverty.

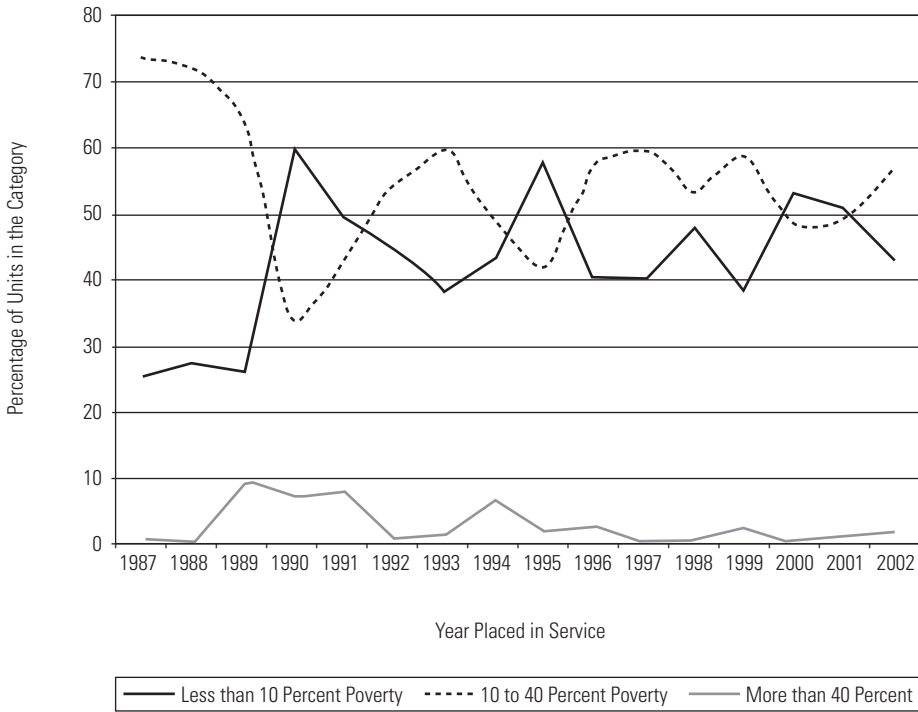
The performance of the two programs is quite different in low- and moderate-poverty tracts. In the central cities, both programs place more households in moderate-poverty areas than would be expected given the distribution of all renters. Few units are located in the low-poverty tracts. In the suburban tracts, an interesting variation is found. In the suburban low-poverty tracts, the LIHTC units outperform the HCVP households by 7 percentage points. In the suburbs, 50 percent of the LIHTC units have been sited in low-poverty tracts. This is 9 percentage points below the suburban renter population as a whole, but 7 percentage points above the performance of the HCVP. It is also well above the 39 percent of suburban renter households living below the poverty line and marginally above the very low income renters living in low-poverty suburbs.

This indicates that the LIHTC program, with its project-based approach, is better able to penetrate the low-poverty suburbs than the voucher program. The LIHTC program may therefore be performing equally well or better than the HCVP.

Figure 4 illustrates that, over the life of the LIHTC program, there appears to be no significant trend toward a greater share of suburban LIHTC units locating in low-poverty areas. However, cycles do exist. During the first three years of the program, it did not perform especially well, since less than 30 percent of the suburban units were placed in low-poverty tracts. After these initial problems, it jumped to its very best performance of 60 percent. It has cycled thereafter, placing between 40 and 60 percent of suburban units in low-poverty tracts. Since 1990, the program has placed 50 percent or more of its units in low-poverty tracts in 5 out of 13 years. Thus, the LIHTC program can perform better than the HCVP in providing housing assistance to low-poverty suburban areas. In fact, without any special effort, the LIHTC program can perform on a par with or better than the MTO program, with its special attention to the issue of concentrated poverty.

One additional issue merits investigation: Do the LIHTC units added to the rental stock of low-poverty neighborhoods threaten to push them above the poverty threshold? Answering this question stretches the capacity of the LIHTC database. The data do not describe the income of the households in LIHTC developments. Some may live below the poverty line. All have low

Figure 4. Percentage of Suburban LIHTC Units by Level of Poverty in Tract and Year Placed in Service



Source: HUD 2005b.

incomes, but many—probably even most—live above the poverty line. If an income of 30 percent of the AMFI approximates poverty line and if the average income of LIHTC residents is about 45 percent of the AMFI, then a minority of LIHTC residents would have incomes below the poverty line. This is corroborated by a HUD study that found only about one-third of households in LIHTC units to have benefited from some form of voucher, which is usually given only to households living below the poverty line (Buron et al. 2000). Therefore, it cannot be concluded that adding LIHTC units to a neighborhood necessarily adds impoverished households.

With that caveat, the number of LIHTC units in a census tract can be compared with the incidence of poverty in that tract. It is possible to estimate how many tracts are currently above the 10 percent poverty threshold but with the removal of the LIHTC units might fall below the threshold if all tax credit units were occupied by households living below the poverty line.

Table 3 indicates that the number of tracts pushed into moderate levels of poverty by the presence of voucher households or tax credit units is extremely small. Of the approximately 7,000 moderate-poverty tracts with tax credit units, only 15 would change to low poverty if all tax credit units were removed. This is only 0.21 percent of the tracts. The incidence is even less with the HCVP. Of the approximately 25,000 moderate-poverty tracts with voucher units, only 31 (0.12 percent) would change to low poverty if all HCVP households were to move out of the tracts.

Table 3. Percentage of Low-Poverty Tracts for Both Programs

	Tracts with LIHTC Units	Tracts with HCVP Households
Tracts with 10 to 40 percent poverty	7,117	24,829
Tracts that would be below 10 percent poverty if assisted units were removed ^a	15	31
Percentage of total	0.21	0.12

Source: HUD 2005b, U.S. Bureau of the Census 2005, and HUD's confidential data set on HCVP households. (See footnote 2.)

^a This assumes that all households are below the poverty line.

These results could be misleading, however. First, it can reasonably be assumed that more than half of the households in LIHTC units are above the poverty line. Table 3 assumes that removing each LIHTC unit changes the poverty population by one household. Because more than half of the LIHTC households are above the poverty line, the threat from the LIHTC units may be even smaller than assumed.

The second problem is potentially more troubling. Tracts typically contain about 1,800 households. Thus, a moderate incidence of poverty means that 180 or more households are below the poverty line. Table 3 indicates that very few tracts are pushed above the 10 percent poverty threshold by the presence of the LIHTC units. However, if the analysis could be done at a finer level of spatial disaggregation, such as census-block groups, then the results could be very different. A typical LIHTC development contains about 70 units. Adding 70 units with only a portion of the units occupied by households below the poverty line would not have a great impact on an otherwise low-poverty neighborhood if a threshold of 180 units must be reached before a tangible negative impact is experienced. However, if a neighborhood is defined as a smaller area with only a few hundred units, then the threshold for pushing it into moderate poverty would be lower, and the potential for a single LIHTC development to push a neighborhood over this threshold would be higher.

Conclusion

The LIHTC program is maturing and going mainstream. It has evolved both financially and spatially. The financial changes bring more dollars into low-income rental housing developments and reduce the need for added layers of subsidy. This makes the program more popular among developers and brings it into the suburbs. The share of LIHTC units going to the suburbs (43 percent) is now about equal to the share placed in central cities (44 percent) and exceeds that of the HCVP (35 percent).

The location of assisted housing developments remains a problem. Project-based assisted housing for the poor is often located in neighborhoods with high concentrations of poverty. The nation's two primary housing assistance programs have improved this condition somewhat by providing access to suburban neighborhoods where the incidence of poverty is generally low. The LIHTC program outperforms the HCVP by sending a higher share of units to low-poverty tracts. In suburban low-poverty tracts, LIHTC units outperform HCVP households by a significant margin, indicating that the project-based LIHTC program is able to outperform the voucher-style HCVP in its capacity to penetrate the low-poverty suburbs.

However, there are limits. It appears that the LIHTC program places more households than expected in tracts with higher poverty compared with all renters but places fewer than expected compared with renters living below the poverty line. In this, the LIHTC program is similar to the HCVP. Thus, both programs provide some opportunity to move the poor to areas with lower levels of poverty but not at levels found across the market for rental housing.

Policy makers are concerned with finding ways to break down the concentration of poverty in housing markets. In spatial terms, LIHTC units now provide affordable housing in markets previously closed to older project-based assisted housing. These tax credit units are making entry into low-poverty suburban areas at a rate equal to or greater than that experienced by the HCVP. In this respect, the LIHTC program is performing better than the HCVP in its standard implementation. It is also performing as well as or better than vouchers, even those with the express purpose of guiding former residents of public housing to suburban areas with a low incidence of poverty. Simply, the LIHTC program is placing units in low-poverty suburbs at a rate equal to or greater than the MTO program. The LIHTC program has the added advantage that the units will not leave the low-poverty suburbs; they are there to stay as affordable units for at least 30 years. Finally, the scale of the LIHTC presence does not seem to threaten to push these low-poverty neighborhoods out of the low-poverty category.

This success must be tempered by the recognition that we know relatively little about the households that occupy LIHTC units. The HCVP tends to serve very poor households that are disproportionately drawn from racial and ethnic minorities. Those participating in the MTO program were chosen from a well-defined set of households in need of housing assistance as well as relocation assistance. It is doubtful that the households living in LIHTC units are comparable. Given the higher tenant contributions toward rent, the households in LIHTC units are not as poor. In addition, the LIHTC program makes very few demands on the owners of LIHTC units. The units must be rented at or below a prescribed maximum, and the tenants must have incomes below a specified maximum. Unless the agency allocating the tax credits dictates otherwise, the ownership is under no obligation to market the units beyond the narrow reach of the low-poverty suburbs. This means that the households being served are among the eligible very low income households, but they seem unlikely to be relocated from the concentrated poverty of the central cities.

The challenge that planners and policy makers face is to exploit the LIHTC program without hindering its success. Katz and Turner (2001) call for the HCVP to be administered at the regional level, facilitating movement by recipients across municipal boundaries, especially to low-poverty suburban neighborhoods. The LIHTC program has demonstrated a higher capacity to enter low-poverty suburban neighborhoods than older project-based housing programs and current voucher programs. The level of political opposition to assisted housing seems to have lessened. The LIHTC program is now mainstream and part of suburban America.

Marr (2005) has called for improved counseling of HCVP households by housing placement specialists. Such outreach efforts are needed to connect these LIHTC units with target households. The goal would be to provide access to these units to the poor and minorities without reawakening the political opposition that previously denied them access to low-poverty suburbs.

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