Federal Court Approves Remedial Plan in Texas Tax Credit Challenge

On August 7, in *Inclusive Communities Project v. Texas Department of Housing and Community Affairs*,[1] a federal court entered an order largely adopting a remedial plan[2] submitted by the Texas Department of Housing and Community Affairs (TDHCA) in response to an earlier ruling that had invalidated the agency's method of allocating low-income housing tax credits[3] under the federal Fair Housing Act.[4] The remedial plan alters the Texas allocation system in ways intended to redress the disproportionate approval of developments in racially concentrated areas. This article briefly reviews the background of the case and the remedial order.

Background

Inclusive Communities Project (ICP)[5] had sued TDHCA in 2008, alleging that TDHCA's discretionary actions under its Qualified Allocation Plan (QAP) had violated the Fair Housing Act and other civil rights protec-

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[1]Inclusive Communities Project v. Tex. Dep't of Hous. & Cmty. Affairs, No. 08cv546, 2012 WL 3201401 (N.D. Tex. Order Aug. 7, 2012), www.tdhca.state.tx.us/multifamily/htc/docs/MemorandumOpinionOrderAdoptingRemedialPlan.pdf. [hereinafter Remedial Order]. This order was slightly amended upon TDHCA's motion in a subsequent order dated Nov. 8, 2012, www.tdhca.state.tx.us/multifamily/htc/docs/20121108-ICP-OrderReNewTrial.pdf [hereinafter Amendment to Order].

[2]Defendants' Proposed Remedial Plan, Inclusive Communities Project v. Tex. Dep't of Hous. & Cmty. Affairs, No. 08cv546 (N.D. Tex. filed May 18, 2012), http://www.tdhca.state.tx.us/multifamily/htc/docs/ProposedRemedialPlan.pdf [hereinafter Remedial Plan]. For a review of the remedial plan, *see* NHLP, *Proposed Remedial Plan at Issue in Texas Tax Credit Allocation Case*, 42 Hous. L. Bull. 141, 149 (July 2012).

[3]Low-income housing tax credits (LIHTCs) are the largest source of federal funding for developing new affordable housing for low-income families. Contemporary affordable housing development and preservation frequently relies on LIHTCs to reduce debt burdens and thereby achieve financial viability. Regulated under rules developed by the Internal Revenue Service, the program requires states to establish a qualified allocation plan (QAP) process to distribute the most valuable 9% tax credits. The credits are based upon the cost of the proposed development, excluding land acquisition. Developers sell the credits to investors, who benefit by having their taxes reduced, in exchange for contributing equity to the proposed development. *See* NHLP, Overview of the Low Income Housing Tax Credit Program (LIHTC), http://www.nhlp.org/lihtcoverview.

[4]Inclusive Communities Project v. Tex. Dep't of Hous. & Cmty. Affairs, 2012 WL 953696 (N.D. Tex. Mar. 20, 2012) [hereinafter *ICP III*]. For a review of the decision, *see* NHLP, *Federal Court Finds Texas Tax Credit Allocation System Violates Fair Housing Act*, 42 Hous. L. Bull. 119, 126 (June 2012).

[5]ICP assists low-income families, primarily African-American, in finding housing in high-opportunity, racially integrated areas. The court also granted intervention to Frazier Revitalization Inc., a private developer. Inclusive Communities Project v. Tex. Dep't. of Hous. & Cmty. Affairs, 2012 WL 2133667 (N.D. Tex. June 12, 2012).

tions. Although finding no discriminatory intent, in 2010 the court ruled that ICP had established a prima facie case of racial discrimination under a disparate impact theory,[6] because the system disproportionately allocated credits to family developments located in very low-income, high-minority communities, while disproportionately denying credits to higher-income, predominantly Caucasian neighborhoods.[7] Earlier this year, the court had also ruled that TDHCA had failed to rebut the plaintiff's prima facie case by showing a sufficient legal justification for its actions.[8] After the court requested that the parties propose a remedy, TDHCA submitted a proposed plan, and ICP submitted comments and objections. The court then evaluated the sufficiency of the plan to remedy the Fair Housing Act violation. ICP sought a remedy applicable only to the five-county Dallas area, which was the focus of the case.

Understanding the remedial plan requires some information about the Texas allocation system. Texas allocates credits according to its Qualified Allocation Plan's (QAP) point system created pursuant to statute,[9] so that the highest scoring development proposals within each region receive credits. State law prescribes the order of "above-the-line" criteria, such as financial feasibility and community support, which must each be assigned more points in the QAP than any of TDHCA's discretionary "below-the-line" criteria.[10] TDHCA's remedial plan, ICP's objections, and the court's order all operate within the framework of this point system.[11]

The Remedial Order

Fundamental for the court was the need to tailor the scope of the remedy to the nature of the violation, and to limit intrusion on the state's administration.[12] Thus, for example, the court limited the remedy to the Dallas metropolitan area, which had been the focus of ICP's litigation, although noting that TDHCA is not barred from applying the remedy in other regions of the state under its usual administrative processes.

Intervenor Frazier Revitalization objected to TDHCA's proposed plan, asserting that it violated the LIHTC statute[13] by failing to give preference to those developments that contribute to a concerted community revitalization plan (CCRP).[14] Frazier contended that that statute requires a preference for proposed developments that are located in qualified census tracts and that contribute to a CCRP, and that the plan fails to do so.[15] This assertion resembles arguments made earlier in the litigation, when TDHCA claimed that the fair housing claim was inconsistent with its duties under Section 42 of the Internal Revenue Code to prefer certain revitalization projects, which the court rejected.[16] Here, the court emphasized its position that there is no such duty under the statute, based upon a proper interpretation of Section 42. The statutory provision defining a QAP requires, among other things, preference in allocating housing credit dollar amounts "among selected projects" to certain kinds of projects.[17] Both Frazier and TDHCA interpreted this provision as requiring the agency to give preference to projects located in QCTs by providing them with additional points in the QAP scoring system. However, the court emphasized that this language requires preference in allocating credits only *among selected projects*, which for the court required a preference for such QCT projects only *after* the project has been selected under other provisions of the QAP. Once a property has been selected to receive credits, the mandated preference must be considered by the agency in allocating credit dollar amounts among selected projects. In most states, as in Texas, because agencies only select a specific number of projects sufficient to absorb all of the available credits, the preference would rarely apply. Only states that select more projects to receive credits than are available would be governed by the mandatory preference for the three types of specified projects. The significance of this legal conclusion for the remedy is that the asserted statutory preference does not apply because the remedial plan only affects how projects are selected, not how credits are allocated "among selected projects."

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[6]Inclusive Communities Project v. Texas Dep't. of Hous. & Cmty. Affairs, 749 F. Supp. 2d 486 (N.D. Tex. 2010) [hereinafter *ICP II*]. *See* NHLP, *Advocates Win Partial Summary Judgment in Tax Credit Siting Case*, 41 Hous. L. Bull. 1, 8 (Jan.-Feb 2011).

[7]Through the Texas process, 78% of LIHTC units built statewide are in census tracts where more than half of residents are minorities. Only 3% are in areas with at least 70% white populations. Karisa King, *State Releases Plan to Rectify Low-Cost Apartment Disparity*, San Antonio Express, May 23, 2012, www.mysanantonio.com/news/local_news/article/State-releases-plan-to-rectify-low-cost-apartment-3577967.php.

[8]ICP III, *supra* note 4.

[9]Tex. Gov't Code § 2306.6710 (2012).

[10]Accordingly, the lowest point value for any "above-the-line" criterion serves as a maximum number of points that may be assigned to any "below-the-line" criterion, limiting TDHCA's discretion accordingly. However, overlapping "below-the-line" criteria, in concert, can create incentives as powerful as "above-the-line" criteria.

[11]The court recognized that any state-imposed impediments are susceptible to elimination or modification as necessary to remedy the FHA violation, but the court sought to preserve the state law discretionary system until modification was demonstrated to be necessary. Remedial Order, *supra* note 1, at 7 and 32.

[12]*Id*.

[13]26 U.S.C.A. § 42(m)(1)(B)(ii) (West 2012).

[14]Remedial Order, *supra* note 1, at 11.

[15]Frazier's factual assertion was based on TDHCA data showing that there were few qualified census tract applications under the current QAP, the revitalization developments might clear high thresholds for additional points, and that High Opportunity Area applications receive points unavailable to revitalization developments, demonstrating the lack of preference. *Id*. at 11-12.

[16]*Id*. at 12.

[17]Specifically, to projects: (1) serving the lowest-income tenants, (2) obligated to serve qualified tenants for the longest periods, and (3) located in qualified census tracts and contributing to a concerted community revitalization plan. 42 U.S.C.A. § 42(m)(1)(B)(ii) (West 2012).

Having disposed of that central issue, the court ordered that TDHCA apply the following remedy within the Dallas metropolitan area:

1. include in the QAP the additional below-the-line criteria provided by the "Opportunity Index;"
2. include in the QAP the additional below-the-line criteria regarding the quality of public education and anti-concentration, and remove all other "Development Location" criteria;[18]
3. continue to provide a 130% basis boost for developments in High Opportunity Areas;
4. continue to include in the QAP criteria for disqualifying proposed development sites that have undesirable features and incorporate the more robust process to identify and address other potentially undesirable site features;
5. promulgate by rule a fair housing choice disclosure for prospective tenants and maintain a website providing information as to tax-credit assisted properties;
6. conduct an annual disparate impact analysis;
7. provide a mechanism to challenge public comments that cause proposed developments to receive negative points and include in the QAP the additional two-point below-the-line criterion regarding support or neutrality from a neighborhood organization that previously opposed a development and an associated debarment rule; and
8. in the event of a tie in scoring a 9% application, adopt a tiebreaker in favor of an application proposing development in a High Opportunity Area.[19]

Some of these actions were more controversial than others. In addition to these specified issues, another specific dispute concerned whether TDHCA should be required to use "forward commitments" as part of the remedy, as suggested by ICP. TDHCA resisted being required to use forward commitments or other waivers as part of the remedy. Although the court noted its authority to do so, it declined to include such affirmative action until absolutely necessary, as determined by periodic reports and the parties' proposals.[20]

A primary component of the remedy is TDHCA's proposal to strengthen the definition of a High Opportunity Area (HOA). Under the 2012 QAP, an HOA was defined as a census tract with both a low incidence of poverty and an above-median income, as well as either recognized elementary schools or significant and accessible public transportation.[21] A project's location in an HOA provides additional points under the scoring system. TDHCA proposed, and the court adopted, a revision to the HOA criteria in the form of a graduated "Opportunity Index," which would, in lieu of a fixed amount of points for a project meeting a specified set of criteria, allocate a sliding scale of one to seven points depending upon the median household income and a school quality factor, so long as the poverty rate was less than 15%. ICP had objected to this formulation, primarily because it applied not just to family units, but also to elderly units, which would not remedy the FHA violation that had been found for disproportionate approval of family units. ICP also sought a revalued point system which would provide more points to the HOA criterion than others. The court rejected these objections, noting its authority to adopt amendments in the process of receiving annual reports and comments from the parties. Without specifically mentioning it, the court implicitly rejected ICP's earlier proposal[22] to establish a set-aside of credits for HOA projects.

Since ICP did not object to the agency's addition of below-the-line criteria providing points that are indicative of educational quality or absence of affordable housing, to its proposal to remove points for all other discretionary criteria related to project location and to strengthen the criteria for disqualifying proposed projects with undesirable site features,[23] and to an annual analysis of disparate impact under each year's QAP, the court adopted them as part of the remedy. Similarly proposed and adopted was a proposal to add a mechanism to challenge the grounds of public comments adverse to proposed developments, forcing a commenting party to provide supporting evidence for its comments.

Another feature of the agency's proposed plan was to continue the 130% basis boost for projects located in HOAs. Although supporting the concept, ICP sought to limit it to family projects in HOAs because elderly units were not part of the FHA violation. Here as well, the court rejected what appeared to be a logical and legally relevant objection, noting its authority to adopt later amendments if warranted by the annual reporting process.

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[18]In its motion to alter or amend the judgment, TDHCA expressed concern that this language might preclude use of its Revitalization Index, which clearly references the location of a development. Thus, the court later clarified that: "Nothing in this judgment precludes TDHCA from following its usual processes to include the Revitalization Index, as set forth in the Plan at 10-11, in the QAP." Amendment to Order, *supra* note 1, at 2.

[19]Remedial Order, *supra* note 1, at 8-9.

[20]*Id.* at 18-19.

[21]*Id.* at 20.

[22]*ICP III*, 2012 WL 953696, at *8; Response to Defendants' Proposed Remedial Plan, Inclusive Communities Project v. Tex. Dep't of Hous. & Cmty. Affairs, No. 08cv546 (N.D. Tex. filed June 18, 2012) [hereinafter ICP Response].

[23]ICP did object to the agency's proposal to use 1,000 feet as the zone of risk for undesirable features, but the court overruled this objection, noting again that this could be revisited under the annual reporting process. Remedial Order, *supra* note 1, at 26.

TDHCA's proposal to include a "Revitalization Index" to provide various points for projects located in qualified census tracts with concerted revitalization plans that also meet other criteria—equivalent to the number of points for developments in HOAs—drew stronger objections. TDHCA proposed this rough equivalency because of its interpretation of the asserted preference required by section 42(m) of the statute, earlier rejected by the court. ICP objected to the inclusion of the Revitalization Index in the plan, primarily asserting its impropriety to address the FHA violation. ICP lodged a similar objection to the agency's proposal to include strengthened requirements for a community revitalization plan. The court agreed, deleting both the Revitalization Index and stronger concerted revitalization plan requirements from the plan, but noting that TDHCA may adopt them as part of its QAP pursuant to its ordinary administrative processes.[24]

The court declined to include several other less significant elements of TDHCA's proposal, or modified them slightly to meet those ICP objections it found legitimate. The court deferred its consideration of the adequacy of the remedial plan's provisions concerning 4% noncompetitive credits, later clarifying that the Remedial Order governs TDHCA's administration of 4% credits only as specified, and any FHA violations created thereby can be addressed in its prescribed annual report and review process.[25]

The court similarly deferred to the annual review process further consideration of ICP's proposed revaluation of the point system to increase the weight of the non-statutory below-the-line criteria. ICP had proposed a point scheme that would de-emphasize those "above-the-line" criteria "posing the highest barrier to non-discriminatory allocation decisions," while adhering to statutory prescriptions.[26] ICP contended that, by narrowing the range of assigned point values, TDHCA could increase the relative weight of discretionary "below-the-line" criteria—from 25% of maximum points in TDHCA's proposal to 35%.[27]

Next Steps

The remedial order requires TDHCA to submit an annual report to the court to ensure that the past violations and their lingering effects have been remedied, and no additional violations have arisen.[28] The parties will confer about the required contents of the report, outlining any specific differences for the court's decision within 120 days. The annual report will be due no later than 120 days after TDHCA issues final LIHTC commitments, with 30 additional days for the parties to file comments. This process will remain in effect for the lifespan of the Remedial Plan, five years after the first annual report is filed.[29] ■

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[24] *Id.* at 24-25 and 27.
[25] Amendment to Order, *supra* note 1, at 2-3.
[26] ICP Response, *supra* note 22, at 35.
[27] *Id.* at 20-21.
[28] Remedial Order, *supra* note 1, at 9.
[29] *Id.* at 34-35.