PUBLIC ORGANIZATIONS AS PRINCIPALS IN AN ERA OF NEW GOVERNANCE: EVIDENCE FROM THE LOW INCOME HOUSING TAX CREDIT PROGRAM

by

ANNE LOCKWOOD WILLIAMSON

(Under the Direction of J. Edward Kellough)

ABSTRACT

This dissertation provides an empirical analysis of the federal Low Income Housing tax Credit program. This program was created as part of the Reagan-era Tax Reform Act of 1986, and implementation is devolved upon the states. It provides a financial incentive through the federal tax code for private-sector developers to construct or substantially rehabilitate rental housing for low-income households. Developers may use the tax credit to offset their tax liabilities or alternatively, and most commonly, the credit may be sold to generate funds to finance construction. Private-sector developers have substantial authority and discretion in the design of rental housing developed with program funds, as well as in the selection of geographic areas and tenants who will be served. Further, private-sector developers who receive federal housing tax credit funding retain ownership of the low-income rental properties resulting from the program.

As a feature of tax policy, the program is largely invisible to the public. In a departure from earlier federal housing programs, there is no requirement that detailed information be collected on tenant characteristics or outcomes. In addition, no information on developer profits arising from program participation is collected. Therefore, meaningful evaluation has proved elusive over the program's more than 20 years of history.

One of the most severe criticisms of this policy is that developers who participate in it earn excessive profits (Olsen, 2000). Drawing on Olsen (2000), I assume that well-managed state programs will suppress the availability of excess profits. My research seeks to explain variations among the states and in a preliminary way make an assessment of the extent to which management of this program in each state has an impact.

Overall, results indicate that the degree of political hierarchy exercised over the public organizations responsible for managing implementation activities is very important. In addition, the professional orientation of governing board members was critical. Those states performing better had boards with stronger representation by those whose primary professional activities involve serving low-income households, and were not dominated by members of the real estate industry.

INDEX WORDS: public management, public administration, policy implementation, new governance, policy tools, public-private partnerships, Low Income Housing Tax Credit, housing policy, principal-agent theory

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DEDICATION

To my daughter

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CHAPTER 1

THE FEDERAL LOW INCOME HOUSING TAX CREDIT AND THE NEW GOVERNANCE

Introduction

This dissertation provides an empirical analysis of the federal Low Income Housing Tax Credit program. This program was created as part of the Reagan-era Tax Reform Act of 1986, and implementation is devolved upon the states. It provides a financial incentive through the federal tax code for private-sector developers to construct or substantially rehabilitate rental housing for low-income households. Developers may use the tax credit to offset their tax liabilities or alternatively, and most commonly, the credit may be sold to generate funds to finance construction. Private-sector developers have substantial authority and discretion in the design of rental housing developed with program funds, as well as in the selection of geographic areas and tenants who will be served. Further, private-sector developers who receive federal housing tax credit funding retain ownership of the low-income rental properties resulting from the program.

As a policy tool implemented through the federal tax code it is virtually invisible to the public at large. Further, in a departure from federal housing policies of earlier

decades, the policy design requires no information to be collected on tenant characteristics or outcomes, nor is there a requirement that private-sector developers participating in the program disclose their level of profits associated with their participation. Thus, meaningful evaluation of tenant outcomes and the performance of developers as third-party implementation agents has never been performed—and this despite the program having more than 20 years' implementation history.

Given that no detailed programmatic information is available allowing the assessment of how well states manage working relationships with third-party implementation agents, this research is exploratory in nature. I begin by assuming that well-managed state programs will suppress the availability of excess profits by developers since the ostensible goal is to provide affordable housing rather than to enrich firms in the housing construction industry. States receive an allocation of federal tax credits based on the size of their populations. Housing economist Edgar Olsen (2000) has observed that many states have annual requests for these credits that far exceed the supply. Olsen (2000) attributes such high demand for the credits to the availability of excess profits. Following Olsen, I take the ratio of demand for the credits over the supply as my proxy measure of the availability of excessive profits. The research seeks to explain variation in the states on this measure and in a preliminary way makes an assessment of the extent to which the management of this program in each state has an impact. Overall, results indicate that the degree of political hierarchy

exercised over the public organizations responsible for managing implementation activities was very important. In addition, the professional orientation of governing board members was critical. Those states performing better had boards with stronger representation by those whose primary professional activities involve serving low-income households, and were not dominated by members of the real estate industry.

The New Governance

The federal Low Income Housing Tax Credit program under analysis in this dissertation is an example of a phenomenon known as the "New Governance." The New Governance is a conceptual framework introduced by Lester Salamon (2002a) intended to facilitate examination of the complexity of modern government arising from an increasing trend toward reliance on purchaser-provider relationships involving the private sector in the delivery of public programs and services. In these purchaser-provider relationships, the role of financing public goods and services is separated from that of providing them. Despite this separation, public organizations remain accountable for the actions of third-party providers, although this accountability presents unique challenges arising from that fact that providers frequently wield considerable authority and discretion in the policy implementation process (Milward & Provan, 2000).

The purchaser-provider relationship between public and private-sector organizations can be described as a principal-agent relationship (Salamon, 2002a;

Milward & Provan, 2000; Kettl, 1993). Although public organizations are increasingly required to coordinate policy implementation activities where third parties have significant authority and discretion, they have seldom been viewed as principals in applications of principal-agent theory. Instead, the typical application of principal-agent theory to public administration depicts an elected official in the role of principal who is plagued with problems in controlling the actions of a budget-maximizing bureaucratic agent (Waterman & Meier, 1998; Wood & Waterman, 1994; Bendor, 1988; Bendor, Taylor & van Gaalen, 1987; Moe, 1984; Miller & Moe, 1983). Waterman, Rouse and Wright (1998) highlight this view of agency theory by describing the principal-agent model as "the dominant theory of the political control of the bureaucracy literature (p. 13)."

However, traditional applications of principal-agent theory to issues in public administration are not adequate to address the role that public organizations increasingly perform; it is no longer sufficient to view only elected officials as principals (Salamon, 2002a; Waterman & Meier, 1998). Because governments are placing more reliance on indirect policy tools to address public problems, third-party organizations play an ever-expanding role in policy implementation. As a result, public organizations face a growing role as principals managing relationships with third-party agents (Salamon, 2002a; Kettl, 2002b; Milward & Provan, 2000; Kettl, 1993). Viewing public organizations as principals is a distinct departure from the view of elected officials as

principals and bureaucrats as agents, yet it has the capacity to support exploration of roles and issues inherent in modern policy implementation.

The New Governance offers a conceptual lens through which to view the increasing participation of private-sector agents in the implementation of public policy. Although the U.S. has a long history of reliance on private contractors to serve various public functions—including provisioning George Washington and the Continental Army—the extent to which private-sector organizations participate in public programs grew dramatically after World War II. Indeed, Kettl (1993) asserts that "every major policy initiative launched by the federal government since World War II—including Medicare and Medicaid, environmental cleanup and restoration, antipoverty programs and job training, interstate highways and sewage treatment plants—has been managed through public-private partnerships (p. 4)."

The reasons behind this growth in private participation in public policy implementation are many, but the most critical reason may be Americans' apparent preference for business-like competition and market forces. Dubbed "the competition prescription" by Kettl (1993, p. 1), this preference has contributed to the popularity of a number of schools of thought regarding the role of private-sector agents and public organizations in public policy implementation.

Competition—and thereby, third-party participation in policy implementation—is offered as a prescription by public choice theorists, privatization advocates,

reinventionists, and advocates of the New Public Management. Public choice theory rests on the work of scholars such as Oliver Williamson (1975), Vincent Ostrom (1974), William Niskanen (1971) and Gordon Tullock (1965); it prescribes competition as a remedy for budget-maximizing tendencies assumed to be an entrenched facet of bureaucratic behavior. The work of E. S. Savas (2000; 1987) is characteristic of the literature on privatization. Savas (2000) defines privatization as "relying more on the private institutions of society and less on government to satisfy people's needs (p. 3)." He attributes privatization with cost effectiveness, as well as with consistency with the Jeffersonian view that "government which governs least governs best (p. 5)."

The reinvention movement is characterized by the work of Osborne and Gaebler (1992). They present the entrepreneurial reinvention of government as a means for improving it. The New Public Management grew out of increasing reliance on competitive norms of the privatization and reinvention movements (Kettl, 2000). Public choice, privatization, reinvention, and the New Public Management share a common thread in that they all prescribe greater reliance on competitive markets and the private sector for solutions to public problems—but without taking into account the very great extent to which third parties already participate in public policy implementation (Salamon, 2002a).

In contrast, the New Governance provides a means through which to analyze the participation of third parties in public policies and programs without offering it as a

prescription. The aim is to move away from a focus on individual agencies or programs and into a more explicit consideration of the networked realm in which modern public administration exists. The departure from the traditional model of direct provision of programs and services by public organizations has dramatic implications for public administration. Rather than training public managers in skills focused on effective functioning as part of a hierarchical organization with a clear chain of authority, public administration is faced with a need to educate itself in the skills of successful collaboration (Salamon, 2002b; Kettl, 2002a; Moe, 1996; Kettl, 1993; Mosher, 1980).

Salamon (2002a) defines the New Governance as "a new approach to public problem solving for the era of 'third-party government' (p. 8)." Salamon states that the use of the word governance, rather than government, is intended to reflect collaboration between government and third parties in addressing public problems. Further, the word new is intended to express a need for new collaborative approaches that explicitly recognize the challenges and opportunities inherent in third-party governance structures.

Milward and Provan (2000) describe governance as a "more inclusive term" than government, "creating the conditions for ordered rule and collective action, often including agents in the private and nonprofit sectors as well as within the public sector (p. 360)." Lynn, Heinrich and Hill (2000) define governance as "*regimes of laws, administrative rules, judicial rulings, and practices that constrain, prescribe, and enable*

government activity, where such activity is broadly defined as the production and delivery of publicly supported goods and services (p. 3; emphasis in original)." In work pre-dating Salamon's use of the term New Governance, Rhodes (1997) used the term new governance to mean "governing without government (p. 652)." Although numerous and growing streams of governance-focused literature exist, this dissertation relies explicitly on the linkage between New Governance and principal-agent theory as presented by Salamon (2002a) for its analytical foundation.

The New Governance concept builds upon previous work by Salamon (1989; 1981) introducing the policy tools framework. With the policy tools framework the author advocated a shift in how scholars approach the study of policy implementation and public management from a focus on agencies and programs to a set of policy tools with similar characteristics. Thus, the unit of analysis becomes a policy tool with a broad array of networked actors, rather than a single public agency administering a program.

Although a multitude of public policies exists, they embody a limited array of mechanisms that define how programs work. The purpose of the shift in focus associated with New Governance is to better capture the complexities of implementation structures, many of which rely on third-party actors over which public agencies have no hierarchical control. Further, these third parties have their own goals and may possess substantial political power. Policy tools have their own political

economy, and the choice of tool is a political issue, not just an economic one (Bertelli, 2006; Salamon, 2002b; Schneider & Ingram, 1990; Elmore, 1987; Salamon, 1981). Finally, the choice of policy tool significantly structures public management's operating choices and has an important impact on results (Lynn, 2003; Salamon, 2002a).

Indirect policy tools are not confined to the simple contracting out of well-defined functions or the purchase of specific goods and services from outside suppliers. Rather, the indirect tools of government include a plethora of instruments such as loans, guarantees, contracts, vouchers, economic regulation, tax expenditures and insurance. Implementation using these tools involves third parties in the exercise of significant discretion in the use of public funds and public authority—indeed, Salamon asserts that in many cases, third parties exercise "the major share" of discretion in the operation of public programs (Salamon, 2002a, p. 2). In many cases, the role of street-level bureaucrat shifts from public official to private-sector actor. As a result, public organizations find themselves being held accountable for programs they do not truly control (Salamon, 2002a; 1989; 1981; Posner, 2002).

Salamon (2002a) and Kettl (2002a) specifically link principal-agent theory with the New Governance, but to date there are no studies expanding upon this linkage. Further, there are no published empirical studies grounded in Salamon's conceptualization of the New Governance, although several efforts based on the policy tools framework exist. Empirical research explicitly based on the policy tools

framework introduced by Salamon (1989; 1981) include work by Howard (1995), Blair (2002) and Ewalt and Jennings (2004).

Howard (1995) compared direct expenditures (also known as direct appropriations) and tax expenditures in the federal budgetary process as a means for determining whether different policy tools exhibited distinctive patterns. Direct expenditures frequently rely on the direct provision of public goods or services by public agencies, while tax expenditures are almost wholly reliant on the private sector for service delivery. Howard found that the chief difference in the two policy tools was that tax expenditures were easier to enact, since they require less scrutiny and approval in Congress than direct expenditure programs.

Blair (2002) relied on the policy tools framework for an empirical analysis of state enterprise zone implementation. The author found that level of direct government involvement had the strongest influence on implementation patterns. Blair advocated for further research grounded in the policy tools framework.

Ewalt and Jennings (2004) performed an empirical analysis of welfare reform activities in the states grounded in both the policy tools framework (Salamon, 1989) and the governance model of Lynn, Heinrich and Hill (2000). The authors found that administrative actions were strongly linked with reductions in the number of welfare clients, while administrative structures and client characteristics had no impact on this measure.

Tax Expenditures as Policy Tools

Tax expenditures are a legal grant of special exclusion from taxation that may take the form of deductions from taxable income, tax credits, tax deferrals or preferential tax rates. As part of tax policy, such provisions are a mechanism through which government can provide financial incentives or assistance to achieve specific national goals (Howard, 2002; McDaniel, 1989; Surrey & McDaniel, 1985). Stated simply, they represent revenue foregone in the pursuit of a particular public policy goal. These expenditures may be extended to personal or corporate income taxes. In the U.S., the most familiar tax expenditure may be the personal income tax deduction for home mortgage interest. This feature of the tax code dates back to the inception of the personal income tax in 1913 (Howard, 1995); the intent of this tax policy is to foster homeownership. Thus, the U. S. government has a long history of using tax policy to address national housing policy goals.

Policy tools that are less visible in the regular budgetary process are less subject to management and control (Salamon, 1989; 1981). Tax expenditures are among the least visible of policy tools. Unlike direct expenditures, they face only one committee for authorization and appropriation (Howard, 1995; McDaniel, 1989).[1] They also tend to be self-perpetuating, in that once introduced into the tax code, they remain there until

[1] Introduction of new tax expenditures became more challenging after passage of the Budget Enforcement Act of 1990. Under this Act, any new entitlements—including tax expenditures—are required to be offset by a tax increase or a spending cut (Howard, 2002).

altered or deleted by Congressional action. This is a stark contrast to direct appropriation programs, which can only continue if approved during each year's budgetary process.

Coordination of tax expenditure and direct expenditure programs may be difficult or even non-existent. Economist Oliver Williamson (1996) noted that tax incentives are seldom coordinated with direct expenditure programs with similar content, because tax incentives are not visible. Further, there may be cause for concern that tax incentives are redundant in some instances. In other words, the activity would have occurred despite their absence (p. 372).

Tax expenditures also have the effect of moving policy control to the private sector, because the decision making process moves from government to the private sector. For instance, when an individual makes a charitable contribution and takes an income tax deduction, the government in effect provides a matching grant to encourage charitable giving. The choice of the charity that will benefit from the contribution, however, is left to the private donor (McDaniel, 1989). In the case of the Low Income Housing Tax Credit, the private-sector developer who competes for tax credits selects where housing will be located, chooses its design, and ultimately determines who will live there. Thus, substantial decision making power rests with the private-sector implementation agent rather than with a public organization accountable for program results.

Tax expenditures may be attractive to some policy stakeholders due to this tool's low visibility. Those who benefit most from a particular tax expenditure program may find this to be a distinct advantage over direct spending programs, because tax expenditures are seldom evaluated (Howard, 2002; Howard, 1995; McDaniel, 1989). Tax expenditures also take precedence over direct appropriation programs in the budgetary process. This arises from the fact that direct spending programs are based on revenues. Because tax expenditures reduce the revenue stream, they are automatically funded prior to direct expenditure programs (McDaniel, 1989).

Summary

While the U.S. has a long history of third-party participation in activities intended to serve a public purpose, the extent of this participation grew rapidly in the post-World War II era (Kettl, 2002b; Kettl, 1993; Mosher, 1980). Moreover, for nearly three decades, there has been a move towards public policy design emphasizing indirect forms of public action. This indirect action is of varying types, but all involve the participation of third-party actors in the exercise of discretion and authority vis-à-vis public programs and resources. These third parties are frequently for-profit, private-sector entities (Salamon, 2002a; 1989; 1981).

Despite this trend, there has been little recognition that the changing environment of public administration places public organizations in the role of principals accountable for the actions of private-sector agents (Salamon, 2002a; Kettl,

2002a, 1993; Milward & Provan, 1998). Further, the success of collaborative programs such as those that include private-sector agents is often assumed without empirical evidence (McGuire, 2006). Instead, many contributions to the literature of public administration and policy implicitly embrace the view that private-sector participation in public policy implementation offers a panacea for resource scarcity or the public ills assumed to be caused by self-interested, budget-maximizing bureaucrats. The literature on public choice, privatization, the reinvention movement and the New Public Management all offer the private sector and market-like mechanisms as solutions to public problems without acknowledging that this represents a normative stand on the role of public organizations and their managers within society. By failing to recognize the great extent to which the private sector already participates in policy implementation, these perspectives diminish our capacity to undertake constructive empirical analyses of the challenges faced by modern public administration in the implementation of public policy.

The New Governance offers an alternative means of relating to the challenges inherent in third-party governance. This conceptual framework explicitly recognizes that each of the new tools of public action has its own set of operating procedures, skills requirements, delivery mechanisms and its own political economy (Salamon, 2002a). Further, the New Governance includes recognition that growing reliance on indirect tools of public action and third-party entities increasingly places public organizations in

the role of principal with regard to private-sector agents. These agents exercise substantial authority and discretion in the implementation of a vast array of public programs. Furthering the understanding of how public organizations can be effective principals may contribute to a knowledge base that will be useful in expanding the tool kit of public managers beyond traditional command and control systems.

Dissertation Overview

As noted previously, this dissertation will examine the relative effectiveness of public organizations serving as principals in the Low Income Housing Tax Credit program, an indirect policy tool characteristic of the New Governance. Because it is funded through tax expenditures, this policy tool is not only indirect, it is also less visible to the public than policy tools based on direct appropriations by Congress. Implementation of this federal program is devolved upon the states, and it relies on private-sector agents to construct or substantially rehabilitate rental housing for low-income households.

Chapter 2 will provide an in-depth description of the Low Income Housing Tax Credit and the roles of state housing agencies and third parties in its implementation. Chapter 3 will expand on principal-agent theory as the analytical framework for this dissertation.

Chapter 4 describes research methods used in the preparation of this work. These research methods include both regression analysis and multiple case studies. Chapter 5 will

contain case studies for low-performing public principals in the Low Income Housing Tax Credit program, while Chapter 6 contains case studies of high-performing public principals. Chapter 7 concludes the dissertation and provides implications of research results and suggestions for future research.

CHAPTER 2

THE LOW-INCOME HOUSING TAX CREDIT: A NEW GOVERNANCE POLICY TOOL

Introduction

Third-party actors have long played a central role in U.S. housing policy. Salamon (2002a) noted that "almost none of the federal government's more than $300 billion annual involvement in the housing field. . .bears much resemblance to the classic picture of bureaucrats providing services to citizens (p. 3)." The Low Income Housing Tax Credit is a prime example. This tax credit provides a financial incentive for private-sector development firms to construct or substantially rehabilitate rental housing for low-income households. As an indirect policy tool characteristic of the New Governance, the Low Income Housing Tax Credit offers an opportunity to use empirical analysis to expand existing knowledge about how public organizations manage their role as principal in working relationships with third-party policy implementation agents.

Between 1987 and 2000, more than one million units of housing were built or rehabilitated under this program (O'Regan & Quigley, 2000). These units received federal subsidies of more than $57 billion dollars during that period, based on data

provided by the National Council of State Housing Agencies (2001).[2] Since its introduction, it has emerged as the primary policy tool for the development of low-income housing in the United States (McClure, 2006; Rohe & Freeman, 2001; McClure, 2000; Cummings & DiPasquale, 1999; Wallace, 1998; Stegman, 1991).

Policy tools have their own political economies (Salamon, 2002a; 1989; 1981), and the political climate in which a policy tool is created will play an important role in shaping its design (Bertelli, 2006; Salamon, 2002a; Schneider & Ingram, 1990; Salamon, 1989; Elmore, 1987; Salamon, 1981). Created as part of the Tax Reform Act of 1986, the Low Income Housing Tax Credit fits well within the Reagan-era political climate ascendant at the time of its creation. It is a supply-side financial incentive offered to the private sector through a less-than-visible mechanism, the tax expenditure. Further, the Low Income Housing Tax Credit differs from previous tax incentives for rental housing development, in that it functions as a block grant to states and is part of an overall pattern of devolution (Orlebeke, 2000). The block grant nature of the program and devolution of responsibility for program administration to the states is also consistent with Reagan Administration ideals.

[2] Data are reported in nominal dollars (e.g., dollar amounts have not been adjusted for inflation). Because the housing tax credit may be taken annually for 10 years, the $5.7 billion in federal credits issued between 1987 and 2000 translates into $57 billion in public subsidy.

Federal Housing Policy and the Low Income Housing Tax Credit

Low-income housing programs are a form of low-income support with policy intent similar to Temporary Assistance for Needy Families (formerly Aid to Families with Dependent Children), Medicaid, Supplementary Security Income and food stamps (Musgrave & Musgrave, 1989). Indeed, annual government expenditures for low-income housing far exceed spending on these other, better-known social welfare programs (Olsen, 2003).

In an economic sense, such programs may be justified through the assumption that higher-income individuals place a value on redistribution that provides a floor for the living standards of society's poor. The choice to provide in-kind support such as low-cost housing is based on the idea that certain uses of assistance are meritorious (Musgrave & Musgrave, 1989). High-income taxpayers who willingly participate in providing such support have been termed paternalistic altruists (Olsen, 1969). The preference for in-kind transfers has also been termed commodity egalitarianism (Rosen, 2002).

Using other economic reasoning, Stevens (1993) described a type of market failure related to distributive inequity as an analytical justification for redistributive policies. Using the federal program of mortgage loan guarantees for veterans as an example, Stevens indicated that the market for home loans was not considered a failure on the basis of inefficiency, but rather on the basis of society's dissatisfaction with

"incomes, opportunities, and rewards for veterans (p. 73)." The response to this societal dissatisfaction was creation of the VA home loan guarantee system, introduced in 1944 as part of the GI Bill.

Williamson (1996) provided another rationale for redistributive public policies. He described redistribution as "an unavoidable cost of democratic government (p. 198)." Further, the author observed that "redistribution is the product of a strategic political calculus," given that the key players in democratic government are politicians and interest groups (p. 198). This view provides some insight when placing U.S. housing policy in historical context.

Housing policy in the U.S. has included various types of low-income housing support for more than 50 years. The Housing Act of 1949 stated an ambitious goal: ensuring "a decent home and a suitable living environment for every American family (Orlebeke, 2000, p. 489)." Federal leadership in the production of subsidized housing for low-income households was the hallmark of the period 1949 to 1973. In 1973, the Nixon administration placed a moratorium on subsidized housing production programs. Once the moratorium was lifted, federal housing policy began to emphasize devolution of responsibility for housing programs. Over time, federal low-income housing policy began to emphasize three approaches: vouchers administered by local public housing authorities and used by income-qualified households to rent housing from private

landlords; block grants made to state and local governments; and housing tax credits administered by the states (Orlebeke, 2000).

The Housing Choice Voucher program (formerly known as the Section 8 voucher and certificate programs) and block grants such as HOME and the Community Development Block Grant (CDBG) require direct Congressional appropriation, while the Low Income Housing Tax Credit is a tax expenditure with automatic annual increases. The automatic increases arise from the fact that the program's funding formula is based on state population; further, it has been indexed to inflation for 2003 and beyond. While Housing Choice Vouchers are widely held to be the most cost effective of the three federal low-income housing policy tools (Olsen, 2003; Orlebeke, 2000), they have also been the subject of much budgetary debate in recent years. Various efforts have been made to trim the federal budget through a reduction in funding for vouchers, and a proposal by the Bush Administration would substantially re-vamp the program and devolve a significant proportion of program costs onto local public housing authorities (Sard & Fischer, 2004). The vulnerability of direct appropriation low-income housing programs to the exigencies of the federal budgetary process stands in stark contrast to the Low Income Housing Tax Credit's status as a tax expenditure program with automatic funding.

Although program implementation began slowly, by 1995 it had become the "primary production vehicle for low-income housing in the United States (Wallace,

1995, p. 793).” With dwindling federal resources devoted to direct-appropriation housing programs, the Low Income Housing Tax Credit continues to be the primary resource for production of low-income housing (McClure, 2006; Khadduri & Rodda, 2004; Cummings & DiPasquale, 1999).

Subsidies in the form of tax expenditures for privately owned housing serving low- and moderate-income households did not begin with the Low Income Housing Tax Credit. Rather, this type of development had received substantial subsidies through the tax system as far back as 1970. Limited partnerships were formed and sold to investors who would use depreciation allowances and tax credits as a means for sheltering other income from taxation in a process known as syndication (Case, 1991).

The rules and profitability of syndication are directly linked with the actions of Congress, which can quickly increase or reduce housing-related tax provisions based on Congressional perceptions regarding the need for a housing stimulus or a dampening of activities in an overbuilt market (Orlebeke, 2000). In response to a highly depressed level of multifamily construction in 1981, Congress enacted accelerated depreciation schedules as a stimulus. Accelerated depreciation allowed rental property owners to write off the value of their property over a period of 15 years, leading to increased after-tax income during those years. As a result, multifamily housing construction activity more than doubled by 1985. Unfortunately, this increased production caused a glut in

many markets that ultimately contributed to the widespread failure of savings and loan associations in the late 1980s (Orlebeke, 2000).

Congress eliminated the accelerated depreciation provision for multifamily housing as part of the Tax Reform Act of 1986. Both the real estate industry and housing advocacy groups lobbied strenuously for new tax provisions that would continue to foster production of low-income rental housing. While the real estate industry was likely motivated by concern for lost profits, housing advocates were concerned that production of low-income rental housing would come close to a standstill due to the termination of the Section 8 New Construction and Rehabilitation program in 1983.[3] The Low Income Housing Tax Credit has proved to be even more lucrative for the real estate industry than the tax preferences it replaced (Jackson, 2006; Orlebeke, 2000; Case, 1991). However, the program's design makes it impossible to determine just how lucrative it is (Case, 1991). The impossibility of determining the true level of profits accrued by third-party implementation agents contributes to an overall low level of program evaluability for the Low Income Housing Tax Credit.

[3] The Section 8 New Construction and Rehabilitation program was a direct-appropriation program administered by the U.S. Department of Housing and Urban Development. It funded development of housing units for low-income households. It should not be confused with the Section 8 voucher and certificate programs, now known as the Housing Choice Voucher program.

Administrative Overview

As a part of federal tax policy, the Low Income Housing Tax Credit is under the authority of the Internal Revenue Service at the federal level, while actual implementation is devolved upon the states. Each state housing credit agency is responsible for administration of an annual allocation of the federal Low Income Housing Tax Credit, including monitoring program compliance during the period in which income restrictions apply to tax credit units. The Internal Revenue Service generally becomes involved in direct issues of program implementation only when instances of gross non-compliance occur. Even in this event, the Internal Revenue Service is dependent upon state housing credit agencies to detect such instances of gross non-compliance and report them to the federal level (GAO, 1997).

Functionally, the tax credit is much like a categorical block grant. States receive a population-based allocation of tax credit authority each year (Guggenheim, 2003; McClure, 2000; Wallace, 1998; GAO, 1997).[4] From 1987 through 1989, states received an annual allocation of $1.25 per capita. Congress reduced the allocation to $.9375 for 1990, but restored it to $1.25 for 1991. The rate then remained $1.25 per capita through 2000. Congress increased the rate to $1.50 for 2001 and $1.75 for 2002, with automatic adjustments for inflation in subsequent years (Guggenheim, 2003). Tenants served by tax credit housing may have household incomes of no more than 60 percent of area

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[4] Since 2001, small states have received a minimum allocation of $2 million.

median (Internal Revenue Code, 2005; Guggenheim, 2003; Joint Committee on Taxation, 1987).[5]

State legislatures were required to choose a single agency to administer the tax credits for their state at the outset of implementation in 1987.[6] Most states chose their existing state housing finance agencies to play the role of designated housing credit agency. The majority of these agencies were created in the 1970s and early 1980s to issue tax-exempt mortgage revenue bonds used to provide individual homeowners with mortgage loans at lower rates than would be possible without tax-exempt bonds. Some of the agencies also issued tax-exempt bonds and made them available to private-sector developers for the construction of multifamily rental housing (Solem, 1987). Currently, about two-thirds of state housing finance agencies are organized as public authorities, based on data published by the National Council of State Housing Agencies (2004).

State housing credit agencies have wide latitude in structuring program implementation. In a study directed at oversight of the Low Income Housing Tax Credit program, the GAO (1997) noted "it is up to the states to identify best practices, consider the costs and benefits of alternative approaches, and select the approaches best suited to their conditions (p. 8)." Therefore, public organizations responsible for program

[5] Household area median income estimates are produced annually by the U. S. Department of Housing and Urban Development. Estimates are made for Metropolitan Statistical Areas and rural counties throughout the country. For example, the estimated median income for a four-person household in Athens-Clarke County, Georgia, was $54,250 in 2005.
[6] Illinois is an exception. There are two authorized housing credit agencies in that state—one is part of Chicago city government, while the other is a state housing finance agency serving the rest of the state.

implementation in the states have broad powers of discretion. Congress intended the Low Income Housing Tax Credit to be a policy tool where responsibility for the management of working relationships with third-party actors is devolved upon the states. Therefore, it is up to the states to see that federal requirements are met and state housing policy goals fulfilled.

States are required to use a competitive process to allocate tax credits to projects proposed by developers. They are also responsible for ensuring that development costs are controlled and that each development receives no more tax credit funding than necessary to make it financially feasible. Since 1990, states have been required to issue an annual Qualified Allocation Plan in which they specify state housing policy priorities and specific criteria that will be used to evaluate and select private-sector applications for Low Income Housing Tax Credit resources in a competitive process (Guggenheim, 2003; Gustafson & Walker, 2002). Further, states have been required to allocate at least 10 percent of their federal housing tax credit resources to developments sponsored by nonprofit organizations since 1988 (O'Regan & Quigley, 2000).

Development Financing with the Low Income Housing Tax Credit

The Low Income Housing Tax Credit program provides a financial incentive for developers to construct or substantially rehabilitate low-income rental housing by providing developers with a federal tax credit that may be taken against annual tax liabilities for a period of ten years (Internal Revenue Code, 2005; Guggenheim, 2003;

McClure, 2000; Wallace, 1998; Joint Committee on Taxation, 1987). In practice, developers receiving an allocation of housing tax credits immediately sell them to banks, large investment firms or certain specialized nonprofit organizations as a means to raise equity capital for the multimillion-dollar development process. The minimum value of the tax credits for an individual development during the statutory ten-year period in which the credit may be taken is typically several million dollars. A developer's choice to keep the tax credits and make use of them to offset their own income tax liabilities would make it necessary to find other financing for the lengthy construction, lease-up and stabilization periods inherent in multifamily development.[7] Therefore, there is a strong financial incentive to sell the tax credits and gain immediate equity capital. The sale of the tax credits not only provides the developer with funding to construct or substantially rehabilitate rental units for low-income households, it also results in an immediate increase in private-sector wealth.

For investors, the Low Income Housing Tax Credit offers a legal means for sheltering corporate and individual income from federal taxation. Banks, investment firms and certain specialized nonprofit organizations purchasing the Low Income Housing Tax Credit from developers are known as syndicators. When syndicators purchase housing tax credits from developers, they typically enter into formal

[7] The period required for construction, lease-up, and stabilization (reaching and maintaining a pre-determined occupancy rate, such as 93 percent) typically takes two to three years (National Council of State Housing Agencies, 2000).

agreements known as limited partnerships. The limited partnerships are structured so that developers and syndicators share property ownership. Under federal requirements, syndicators must have an ownership interest in the property in order to make use of the tax credits (Internal Revenue Code, 2005; Guggenheim, 2003). The most active group of syndicators is relatively small, totaling about 20 organizations in 2003 (Guggenheim, 2003). Tax credit syndicators include operating units of large bank holding companies, such as Wachovia and Bank of America. Large bank holding companies find the housing tax credit particularly attractive, as an investment in these credits not only helps them shelter income from taxation for a period of ten years, but also counts toward fulfillment of their obligations under the Community Reinvestment Act of 1977. This act was passed in response to concerns about "red lining," a practice whereby banks reportedly refused to make loans in certain low-income areas—areas that were frequently minority neighborhoods. The act requires banks to undertake a minimum level of activity in serving low-income households. The opportunity to use syndication of the Low Income Housing Tax Credit as a part of fulfilling Community Reinvestment Act requirements adds to the attraction of the program for the banking industry.

Investment firms and multifamily mortgage lenders, as well as certain nonprofit organizations, also serve as syndicators. For-profit non-bank syndicators may hold a portion of the credits to offset their own tax liabilities, but sell off other portions to corporations and wealthy individuals in search of tax shelters. Specialized nonprofit

organizations performing the tax credit syndication process typically use a for-profit affiliate to transform the tax credits into development equity. Non-bank syndicators include for-profit entities such as Boston Capital and nonprofit organizations such as the Enterprise Foundation.

Purchases of tax credits are made at less than face value. In 2003, syndicators paid about 80 cents for each dollar of Low Income Housing Tax Credits purchased (Guggenheim, 2003). Thus, syndicators purchasing the credits received a one dollar reduction in federal taxes for every 80 cents they spent on the purchase of Low Income Housing Tax Credits. In addition, these tax credits may be taken annually for a period of ten years. Tax credit syndicators set the rate paid for housing tax credits by bidding against one another for the opportunity to purchase tax credits from developers serving as implementation agents. Corporate and individual investors who purchase tax credits from syndicators will pay more than 80 cents for one dollar of tax credits, but still obtain the ability to reduce federal tax liabilities by an amount exceeding that paid for the credits.

With an average market rate of 80 cents for each dollar of tax credit allocated to low-income developments, taxpayers receive no more than 80 cents in public purpose for each dollar of tax revenue foregone. The actual amount of proceeds applied to development will vary among projects and is likely to be lower than 80 cents for each tax revenue dollar foregone. This arises from the fact that there are substantial fees

involved with the syndication process associated with the services of tax attorneys and certified public accountants, among others. Wallace (1998) estimated that administrative and marketing costs associated with the low-income housing syndication process average 20 percent of syndication proceeds. Therefore, a tax credit sale price of 80 cents on the dollar would yield 64 cents of public purpose for each dollar of federal tax revenue foregone. The loss of public purpose from each dollar of tax revenue foregone under this program is described as deadweight loss (Samuelson & Nordhaus, 1995). Because the Low Income Housing Tax Credit is an indirect tool of public action embedded in the tax code, it is unlikely that the general public is aware of the deadweight loss or its size.

The Low Income Housing Tax Credit provides developers with up to 70 percent of the total cost of developing a property less certain costs, such as land (Guggenheim, 2003). Developers may seek other sources of public subsidy to supplement the equity funding provided through sale of the tax credits, including a number of subsidies funded at the state level. The General Accounting Office (1997) estimated that 69 percent of housing tax credit developments placed in service in the 1990s used additional subsidies as part of their financing packages. By using housing tax credits in combination with other public subsidies, private-sector firms have the potential to develop multifamily rental properties with a minimum of private-sector financial resources. This potential may make the program more financially appealing to third-

party implementation agents than originally envisioned by Congress, since the use of additional subsidies makes it possible to create substantial private-sector wealth in the form of multifamily rental property with little or no private funds being placed at risk.

Third-Party Discretion and Goal Conflict

While state housing credit agencies have broad discretion in administering the Low Income Housing Tax Credit program, an array of third-party actors—the largest segment of which are for-profit development firms—have discretion in the location and design of properties, as well as in tenant selection. An analysis of limited program data made available by the U. S. Department of Housing and Urban Development for the period 1987 through 2003 indicates that approximately 80 percent of the housing tax credit rental units have been developed by for-profit organizations.[8]

For-profit dominance in the competition for Low Income Housing Tax Credits heightens the potential for goal conflict in program implementation. The goal of corporate financial management is to maximize shareholder wealth (Brigham & Ehrhardt, 2003; Samuelson & Nordhaus, 1995). In contrast, the goal of public agencies is to serve the public interest (Goodsell, 1990). Thus, the potential for goal conflict between private-sector developers chiefly motivated by profits and state housing credit

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[8] Analysis of data publicly available through the U. S. Department of Housing and Urban Development indicates that between 1987 and 2003, 80 percent of the units developed with the LIHTC were developed by for-profit entities. Dataset available at http://lihtc.huduser.org/.

agencies working to fulfill state housing policy priorities is constantly present in the implementation process.

Cummings and DiPasquale (1999) described the potential for goal conflict between public-private collaborators within the Low Income Housing Tax Credit program. They noted that "government officials. . .often have policy goals that may be viewed by private participants as bringing too much additional risk (p. 252)." For instance, "states may target populations with special needs or may favor the provision of social services as part of a project, both of which can increase management risks. They may want to serve lower-income tenants who pay lower rents; target underserved areas, which may increase development costs; or favor nonprofit developers. . .to increase community participation or to achieve broader community development goals. Clearly, there can be real tension between the policy goals for LIHTC [Low Income Housing Tax Credit] projects and financial viability (p. 252)."

Financial viability may be viewed differently by public organizations administering the tax credits than by private-sector development firms, particularly when these firms are for-profit entities. For instance, for-profit developers have a motivation to locate properties in the highest income areas possible. This motivation arises from the fact that the rent permissible under the tax credit program is based on area median incomes. This manner of setting permissible rents differs from a number of housing programs introduced in earlier eras, where rents were based on actual

household income (Smith, 1994). Rents in tax credit developments must be based on federal affordability guidelines for households at no more than 60 percent of area median income, as determined each year by the U.S. Department of Housing and Urban Development (Guggenheim, 2003). However, the actual tenant in any given tax credit unit may not have an income as high as 60 percent of area median. Therefore, there is a potential for tenants to experience housing cost burden, despite residing in a publicly subsidized property.

States are not required to report data on households served (Olsen, 2003; GAO, 2002). Therefore, there is limited information available about the income level of those who actually live in tax credit developments. Two reports published in the late 1990s provide the most widely available information on actual tenant incomes. The General Accounting Office (1997) conducted a study of tax credit developments placed in service between 1992 and 1994. They found that three-quarters of the households living in tax credit developments had average incomes of less than 50 percent of area median. In a report commissioned by the National Council of State Housing Agencies, accounting firm Ernst and Young (1997) found that tax credit tenant households had average incomes of 45 percent of area median. Although there is a slight disparity in tenant income levels reported by each source, their results are consistent in that they show that the majority of tax credit tenant households have incomes well below the maximum allowable level of 60 percent of area median. By far, the majority of tax credit

units have rents targeted to households earning 60 percent of area median. Based on the limited data provided by these reports, it appears that the majority of tax credit tenants experience housing cost burden. This cost burden experience runs counter to the policy intentions of federal programs, where households are intended to have at least 70 percent of their gross monthly income available for expenses such as food, child care, transportation, health care and other non-housing needs.

Basing housing tax credit rents on area median incomes rather than tenant incomes not only directly affects low-income tenants; it also has implications for where developments are located. For example, Osceola County, Florida is part of the Orlando MSA. Under program requirements, the maximum rent for a two-bedroom unit in a tax credit development was $738 in 2004. In contrast, the maximum rent allowable for a two-bedroom tax credit unit in rural Dixie County, Florida, was $583 in 2004 (Danter Company, 2004). Higher rents are attractive to for-profit developers not only for the larger cash flow they are likely to represent, but also because higher rents translate into higher property values. One of the most commonly used methods for appraising multifamily rental property calculates market value based on the stream of rental income over time (Betts & Ely, 2004). Therefore, developers have a financial incentive to locate properties in Osceola County rather than Dixie County, although the need for

additional low-income housing may be proportionately greater in the low-income rural area than in the high-income urban area.[9]

For-profit development firms may enhance the financial rewards obtained from successful application for Low Income Housing Tax Credit resources by engaging in vertical and horizontal integration. They may vertically integrate by serving as their own general contractor. Thus, they gain not only immediate ownership interest in a multimillion dollar development through the sale of tax credits to syndicators, but also earn a builder's profit in addition to a developer's fee by serving as their own general contractor in the development process. Both builder's profit and developer's fee are typically calculated as a percentage of the total cost of development. The amount of the tax credits allocated is also based upon total cost of development (less certain costs, such as land). Thus, while the state agency administering the credits has a legal requirement to see that costs are controlled, for-profit development firms have very strong incentives to increase total development costs.

Horizontal integration occurs when tax credit developers operate a property management company. When development companies own their own property management company, they earn substantial fees each month from the management of their own developments. These management fees are paid to the developer-owned

[9] In addition to the higher rents available in the metropolitan Orlando area (which includes Osceola County), the urban area may also be more attractive to developers because they can typically build and lease much larger developments there—300 units, for instance, rather than the 30 or 40 units that might be feasible in a rural county—and reap additional financial benefits from economies of scale.

management company from rent paid by low-income tenants. This provides additional income to the development firm over the term during which it owns the property.

Some consider the Low Income Housing Tax Credit to be a form of corporate welfare (Orlebeke, 2000). In other words, the redistributive aspects of the program primarily benefit for-profit implementation agents, rather than low-income tenants the program is meant to serve. Olsen (2000) stated that developers earn excessive profits through the Low Income Housing Tax Credit. Excessive profits are known in lay terms as windfall profits, and the term means that the profits derived from a venture are greater than that which would normally be expected for a given level of business risk (Radcliffe, 1990).

Case (1991) supported the notion of excessive profits for tax credit developers by observing that they spend large sums of money to compete for credits. He asserted that they would be unlikely to spend these sums if windfall profits were not made through the program.

Jackson (2006) observed that there is no evidence that housing units built with the Low Income Housing Tax Credit would not have been built in the absence of the subsidy. If development activities would have occurred in the absence of the program, then assertions that the program is a form of corporate welfare may be well founded.

Finally, McClure (2000) found that for-profit firms engaging in tax credit development specialized in this type of development; in other words, these firms did

not typically engage in market-rate development (e.g., development without public subsidy). If for-profit firms choose to engaged in the complex and costly process of developing using the Low Income Housing Tax Credit rather than the more streamlined and flexible financing mechanisms available to market-rate developers, this provides some evidence that there is a financial benefit available through housing tax credit development not available through conventional, market-rate development. Economic reasoning indicates that otherwise, development firms would forgo the Low Income Housing Tax Credit program and undertake market-rate opportunities.

State Policy Priorities and Management Practices

As public organizations responsible for administration of the Low Income Housing Tax Credit program, state housing credit agencies face immense challenges in using this indirect tool of public action to meet state policy priorities. They are reliant on a quasi-market system of competition to produce redistributive policy outcomes in providing rental housing for low-income households, yet third-party implementation agents have substantial motivation to steer program redistribution towards increasing their own profits. Given the inherent challenge in producing meaningful redistribution through a quasi-market competitive process and the broad discretion states are granted in the administration of the Low Income Housing Tax Credit, it is likely that state housing credit agencies will vary in the effectiveness with which they manage working relationships with third-party organizations participating in program implementation.

Given the potential for goal conflict between the public interest embodied in state housing policy priorities and the goals of private-sector firms developing housing with the Low Income Housing Tax Credit, how do state housing credit agencies structure third-party arrangements so that state housing policy priorities are met? The formal method for structuring these working relationships is the Qualified Allocation Plan. Each state's Plan defines state housing policy priorities and specifies the competitive process for selecting developments for funding. All but one state (Missouri) uses a scoring system to structure the competitive process for tax credit resources.

Scoring systems vary widely among the states. Some states may give preference to proposed developments serving a particular geographic area, while others may give preferences for developments intended to serve certain people, such as the elderly or persons with disabilities. Many other selection preferences exist, depending on state priorities (Gustafson and Walker, 2002).

In reviewing Qualified Allocation Plans from each state, Gustafson and Walker (2002) found "wide variation in how actively states used their QAPs [Qualified Allocation Plans] to target housing needs (p. 4)." This is consistent with GAO findings in 1997: "[S]tates had defined and weighted the selection criteria for awarding credits in different ways. There was also considerable variation in their plans and in the data and analyses used in assessing housing needs (p. 5)."

The block grant nature of the Low Income Housing Tax Credit program makes it possible for states to pursue different policy priorities. Given the economic and demographic diversity of the states, it is likely that they will differ in policy priorities. Gustafson and Walker (2002) and the GAO (1997) found substantial differences among state Qualified Allocations Plans. In an empirical analysis of the Low Income Housing Tax Credit, Sinclair (1998) found that states produced significantly different outputs, consistent with the block grant nature of the program. However, there has been no effort to date to explicitly link differences in state policy priorities with actual production of different state outputs.

In addition to variation in policy priorities and selection criteria, each state housing credit agency's management practices are likely to vary. It may be reasonable to expect that differences in management practices will produce varying levels of effectiveness in influencing the efforts of third-party implementation actors. As described by the GAO (1997), "Under the tax credit program, it is up to the states to identify best practices, consider the costs and benefits of alternative approaches, and select the approaches best suited to their conditions (p. 8)."

One of the primary responsibilities of state housing credit agencies in Low Income Housing Tax Credit implementation is to ensure that developments receive no more tax credits than are necessary to make a development financially feasible. The intent of this is to spread the federal allocation among as many developments as

possible, while also decreasing the possibility that developers might make windfall profits through program participation. With regard to this responsibility, the GAO found that "states had established controls that varied in their coverage and stringency for helping ensure appropriate tax credit awards (p. 9)." Thus, it may be reasonable to assume that states vary in the efficacy with which they constrain the potential for third-party implementation agents to obtain windfall profits through participation in the Low Income Housing Tax Credit program.

Summary

The federal Low Income Housing Tax Credit is an example of an indirect tool of public action characteristic of the New Governance. Responsibility for program administration is devolved upon the states, and each state is empowered to determine its own housing policy priorities. Policy implementation is complex, involving a competitive selection process conducted by state housing credit agencies and wide discretion on the part of third-party implementation agents in the design and location of low-income rental housing, as well as in tenant selection.

The majority of third-party implementation agents are for-profit development firms. Because these firms' primary goal is likely to be profit maximization, there is an inherent tension in the goals of third-party agent and the public organizations responsible for the program. As entities intended to serve the public interest, state

housing agencies' goals will be to fulfill policy priorities, rather than maximize the profits of for-profit agents.

Although the Low Income Housing Tax Credit is now the centerpiece of U.S. housing policy dedicated to development of low-income rental housing units, it has been criticized as being a form of corporate welfare. Because states vary in their policy priorities and management practices, however, the extent to which this assertion is true is likely to vary from state to state.

CHAPTER 3

PRINCIPAL-AGENT THEORY AS AN ANALYTICAL FRAMEWORK

Principal-Agent Theory and the New Governance

The New Governance is intended to focus attention on networks of actors taking part in modern-day public policy implementation efforts. Salamon (2002a) linked the New Governance with principal-agent theory. According to Salamon:

> *Principal-agent theory* is part of a broader body of concepts designed to explain the existence of organizations in a market system. What is relevant. . .is the insight this theory provides into one of the central paradoxes that arises in relationships between principals and agents in contractual or other third-party arrangements of the sort that third-party government entails. Despite the apparent influence that principals in such relationships wield by virtue of their control of the purse strings, it turns out that the agents frequently end up with the upper hand. This is so, principal-agent theory explains, because the agents in such relationships typically have more information than their principals about what they are doing with the discretion that is inevitably left in their hands (p. 12; emphasis in original).

Salamon further described principal-agent issues within New Governance-style policy implementation:

> When multiple organizations are involved in a given task, the chances increase that the interests and values of the principal and the agents will diverge. The more dispersed the authority, therefore, and the less the coincidence of interests and perspectives between principals and agents, the greater the risk of goal displacement and principal-agent difficulties. Not just the extent of indirectness but also the type of third-party partner

> a tool engages thus can affect the extent to which public purposes are achieved (pp. 30-31).

In presenting principal-agent theory as a framework for the exploration of issues associated with public-private partnerships, Kettl (1993) noted:

> Even as the sharing of responsibilities between the public and private sectors blurs the boundaries between them, the separate interests of each sector remain. The most important issue is whether the sharing of public and private power endangers the public interest that the government is obliged. . .to pursue (p. 39).

Principal-agent theory provides a means through which issues of private-sector discretion and authority in public policy implementation may be addressed. In an empirical analysis of the Low Income Housing Tax Credit—a policy tool reliant on a quasi-market system of private competition for public resources to achieve policy goals—the theory may be especially relevant. This relevance arises from the theory's historical application to issues of authority and discretion in the realm of economic markets, organizational theory and political science.

The Principal-Agent Relationship

Principal-agent theory has its roots in the literature of insurance (Spence & Zeckhauser, 1971) and transaction cost economics (Williamson, 1975). Over the last three decades, however, it has been increasingly applied in a number of academic disciplines, including organization theory, political science and public administration (Waterman & Meier, 1998; Eisenhardt, 1989; Williamson, 1975; Spence & Zeckhauser,

1971). The theory describes an agency relationship wherein the principal enters into a contractual agreement with an agent with the understanding that the agent will engage in appropriate actions to produce the principal's desired outcome.

Agency relationships form the basis for nearly every transaction within society (Arrow, 1991; Mitnick, 1975; Ross, 1973). Some of the most familiar principal-agent relationships include lawyer-client, doctor-patient, broker-investor, and employer-employee (Moe, 1984). Despite its popularity with scholars, its features are rarely explained (Waterman & Meier, 1998; p. 174).

Principal-agent theory rests on four basic concepts: information asymmetry, adverse selection, moral hazard and goal conflict. Information asymmetry exists between principal and agent, because the agent has information not available to the principal. For instance, a principal may seek to hire an agent for tasks that are too complicated or costly to undertake on his or her own behalf. The principal in such a situation will likely seek out an agent whom he or she believes to have specialized skills or knowledge related to the task for which the agent is hired (Waterman & Meier, 1998; Pratt & Zeckhauser, 1991; Sappington, 1991; Perrow, 1986). However, the principal cannot have complete knowledge about the true level of skills or knowledge possessed by the potential agent.

The information asymmetry inherent in the agent hiring process leads to the condition referred to as adverse selection. Adverse selection arises from the

"unobservability of the information, beliefs, and values" of others (Moe, 1984; p. 754). Therefore, while the principal seeks a highly qualified and motivated individual to serve as agent, the principal cannot know the true intelligence, work habits or aptitudes of another individual—in this case, the potential agent. The potential agent in this transaction has information about his or her true level of qualification and motivation not available to the principal; in other words, a condition of information asymmetry exists. Based on this condition, the principal may select an agent who is less qualified or motivated for the task than desired. When this type of selection occurs, it is referred to as adverse selection (Moe, 1984).

Moral hazard is linked with information asymmetry and becomes important once an agent has been selected (Waterman & Meier, 1998; Wood & Waterman, 1994; Eisenhardt, 1989; Moe, 1984). In this instance, the principal cannot have perfect information about the performance of an individual agent or the extent to which he or she is productive (Waterman & Meier, 1998; Sappington, 1991; Pratt & Zeckhauser, 1991; Eisenhardt, 1989; Levinthal, 1988; Moe, 1984). Instead, the principal must rely on proxies such as report quality, timeliness and apparent diligence. The agent now has an incentive to direct his or her efforts toward the proxy measures; this may lead to goal displacement, because the observable proxy goals may not be in complete accord with the abstract goals implicit in the employment contract. The agent may shirk—e.g.,

substitute leisure for productive effort—since the unobservable nature of his true productivity allows him to do so with little expectation of being detected (Moe, 1984).

The concept of shirking has been broadened in recent years to include costs of production and pursuit of alternate goals. Because the agent may possess more information than the principal about the true cost of attaining a particular goal and the true level of profits accruing to the agent, outputs may be produced at a higher cost than necessary. Waterman and Meier (1998) construed this as a form of shirking or moral hazard. Further, Songer, Segal and Cameron (1994) described the actions of circuit court judges handing down decisions satisfying their own policy interests rather than those of the Supreme Court as shirking.

Finally, goal conflict is the crux of the problem confronting the principal in managing the working relationship with the agent. If the goals of the principal and agent were identical, there would be little need for concern about information asymmetry, adverse selection or moral hazard. Without goal conflict, the agent would perform on behalf of the principal just as the principal would if he or she possessed the time and expertise to carry out the function without the agent's assistance (Eisenhardt, 1989; 1985).

However, principals and agents do not typically share identical goals. This lack of goal congruence sets the stage for the agent to exploit information asymmetries to their advantage in both the selection process and in work performance (Koppell, 2003;

Waterman & Meier, 1998; Milgrom & Roberts, 1992; Miller, 1992; Pratt & Zeckhauser, 1991; Eisenhardt, 1989; Mitnick, 1980). Thus, despite the principal's best efforts to obtain agent services that will produce the outcome most consistent with the principal's goal, this result may be elusive.

Concepts underlying principal-agent theory are summarized in Table 1.

Table 1
Principal-Agent Theory: Underlying Concepts

CONCEPT	DESCRIPTION
Information Asymmetry	The agent possesses information about his or her true qualifications and goals not available to the principal. Further, once hired, the agent possesses information on true level of effort and performance that cannot be observed by the principal.
Adverse Selection	The principal cannot have complete information about the true qualifications and goals of agents who offer their services. Therefore, the principal may not select the agent most likely to perform in a manner consistent with the principal's goals.
Moral Hazard	Once an agent has been selected, the principal cannot observe the true behavior and goals of the agent. This lack of observability allows the agent to withhold their full effort (shirk) or otherwise fail to perform in the best interest of the principal. Shirking may include producing outputs at a higher cost than necessary or pursuing alternate policy goals.
Goal Conflict	The goals of the principal and agent differ, enhancing the risk of adverse selection and moral hazard. The agent may engage in behaviors designed to attain his or her own goals, rather than the principal's goals.

Hierarchy and the Principal-Agent Relationship

Salamon (2002a) described agents as having the "upper hand" in the relationship between principal and agent (p. 12). If Salamon's assertion and the assumptions of the

principal-agent model are an accurate reflection of reality, what course of action is open to the principal? The creation of a hierarchical relationship between the principal and agent is offered as the solution to the principal's problem (Williamson, 1996; 1975; Miller, 1992). Miller (1992) defined hierarchy as "the asymmetrical and incompletely defined authority of one actor to direct the activities of another within certain bounds (p. 16.)"

How is hierarchy introduced into the principal-agent relationship? The principal must anticipate the agent's responses and design of a set of incentives wherein it will be in the agent's best interest do what is necessary to achieve the principal's goal (Ekanayake, 2004; Miller, 1992; Eisenhardt, 1989; 1985). Stated in the formal terms of economics and organizational theory, the principal-agent relationship is institutionalized in the form of a contract, where the contract provides the principal with the degree of control necessary to meet his or her goals (Miller, 1992; Eisenhardt, 1989; 1985).

Hierarchy also implies the presence of a management control system. The control system is made up of structures, procedures, information systems, monitoring, performance evaluation, rewards and penalties. This system helps principals curb self-serving behavior by agents through the reduction of opportunities and incentives for such behavior (Ekanayake, 2004).

Koppell (2003) distinguished between two types of managerial control systems, administrative control tools and regulatory control tools. One type is associated with traditional government agencies, while the other is associated with quasi-governmental or hybrid organizations. Administrative control tools available for use with traditional government agencies include "the entire range of laws, structures, practices and conventions associated with the principal-agent relationships of U.S. government agencies (p. 37)." In contrast, the tools available for use with quasi-governmental organizations rely on regulatory control. Regulatory control tools include "regulations, rules, contracts and procedural requirements (p. 37)."

The potential for introduction of hierarchy is not confined to the model of a single principal with a single agent; recent contributions to the literature offer a more nuanced view of hierarchy and its role in networked relationships. For instance, Moynihan (2005) explored networks and hierarchies in the provision of emergency management services. The author posited that hierarchies and networks are not necessarily two ends of a continuum. He introduced the concept of a hierarchical network in which hierarchical control and rules are used to manage a network of organizations. McGuire (2006) also observed that networks can be rule-focused and hierarchically driven. Thus, a hierarchical solution to the principal's problem can be introduced into a network composed of a principal working with multiple agents over

whom the principal does not have the traditional form of authority and control associated with an employment contract.

Principal-Agent Theory and Bureaucracy

Many applications of principal-agent theory are found in the literature related to political control of the bureaucracy. These theoretical and empirical efforts are based on earlier work by William Niskanen (1971), who described the problem confronting elected officials as the need to control the budget-maximizing tendencies of bureaucrats. One facet of Niskanen's work seems to have been little regarded by subsequent scholars who extended the application of agency theory to bureaucracy: Niskanen's model of the budget-maximizing bureaucrat does not rely on a necessarily self-serving bureaucrat, but rather may include one who seeks to maximize program budgets in order to serve societal needs. Thus, the budget-maximizing bureaucrat in this seminal work is capable of altruistic motivation in serving the public.

Niskanen's work was followed by calls for formal models of bureaucracy based in principal-agent theory by public choice theorists such as Terry Moe (1984). Although Moe's work strengthened the unflattering (and likely unrealistic) view of the self-interested bureaucrat by relying on the work of transaction cost economists such as Oliver Williamson (1975), it did provide a basis for later efforts addressing important aspects of the working relationship between elected officials and public managers.

By the late 1990s, the principal-agent model was described as the dominant theory regarding the political control of the bureaucracy (Waterman, Rouse & Wright, 1998). Further, there was a strong scholarly consensus that political control of the bureaucracy is possible (Waterman & Meier, 1998).

In early work based in agency theory, Mitnick (1980) found evidence that regulatory oversight provided a solution to the principal's problem with agents. Through regulatory means, the principal has the ability to apply sanctions or provide rewards to induce or maintain the desired agent behavior. In an analysis of the federal Clean Air Act of 1970, McCubbins, Noll and Weingast (1989) found evidence that the best method for political control of the bureaucracy was placement of *ex ante* procedural constraints on bureaucratic decision making processes. Relatedly, Wood and Waterman (1994) asserted that political control of the bureaucracy is possible, since elected officials create bureaucracies and therefore have the ability to design incentive structures that facilitate control.

In a review of Environmental Protection Agency enforcements, Waterman and Wood (1993) found congressional oversight committees were successful in influencing changes in the agency's policy implementation. Further, Hedge, Scicchitano and Metz (1991) found that federal oversight behavior was a powerful predictor of state regulatory vigor in the implementation of the Surface Mining & Control Act of 1977.

Worsham and Gatrell (2005) presented a signaling model of agency, positing that communications from political principals provide the primary means through which they influence the behavior of bureaucratic agents. Using an empirical analysis of the Bureau of Indian Affairs and the Federal Energy Regulatory Commission, the authors found bureaucratic agencies were responsive to communications from political superiors. Bureaucrats were viewed as constantly monitoring the communications of their principals via newscasts and other public venues, seeking issue salience and adjusting behavior in accord with perceptions about political principal's communications. In essence, the politicians' communications gave bureaucrats "signals" as to how important issues were viewed and how they should be addressed; bureaucrats then acted in accord with these signals.

The issue of agent expertise may contradict, at least in part, the results obtained by scholars who have found support for the premise that political principals are able to control the behavior of bureaucratic agents. For instance, in a game theoretic experiment Altfield and Miller (1984) found that agents use expertise as a weapon in dealing with the principal. Further, Bendor, Taylor and Van Gaalen (1987; 1985) offered evidence that technical expertise gives bureaucrats the ability to engage in agenda control. By engaging in such control, bureaucrats were able to influence the choices of their political superiors. However, Waterman and Meier (1998) found a contravening influence in the role of bureaucratic expertise through elected officials' access to their

own sources of expertise, such as the Government Accountability Office, the Congressional Budget Office and legislative staff.

Other empirical evidence relevant to the principal-agent relationship in a public setting is offered by Songer, Segal and Cameron (1994), Milward and Provan (1998) and Koppell (2003). Songer, Segal and Cameron examined the relationship between the Supreme Court and appeals court judges, placing the Supreme Court in the role of principal and the appeals court judges in the role of agents. The authors found that appeals court judges found opportunities to satisfy their own policy preferences when handing down decisions, construing this in agency theoretic terms as shirking or moral hazard. Overall, however, the authors found appeals court judges to be relatively faithful agents of their principal, the Supreme Court.

In a reinterpretation of earlier work (1995) related to the performance of community mental health networks, Milward and Provan (1998) placed public organizations in the role of principal with regard to a network of implementation agents. The authors found that the introduction of higher levels of hierarchy into the network by the public organization principal resulted in higher levels of satisfaction with services, as measured by survey results obtained from clients and their families. Milward and Provan (2000) also noted that an expectation of continued interaction between principal and agents into the foreseeable future will reduce opportunistic behavior and increase the probability of cooperation on the part of agents. This

expectation provides stability to the principal-agent relationship and "increases the probability that individual actors will develop norms of reciprocity and learn to solve social dilemmas (p. 376)." However, despite the potential for development of norms of reciprocity and cooperation, the authors also found that agents were willing to organize themselves to apply political pressure to public organization principals. This instance of agent backlash notwithstanding, the authors found the quality of the principal-agent relationship to matter more than adequate program funding in terms of policy implementation success.

Finally, Koppell (2003) applied principal-agent theory to the issue of political control of hybrid organization agents. His work focused on analysis of quasi-governmental entities such as FannieMae and Freddie Mac, known as government-sponsored enterprises or GSEs.[10] Hybrid organizations have been credited with being more flexible and efficient than traditional public organizations, but their quasi-government status brings a new dimension to the issue of bureaucratic control. As quasi-governmental entities, they raise important questions about the level of accountability and control to which such organizations may be subject. Koppell's empirical evidence pointed to hybrids as less reliable bureaucratic agents than traditional public agencies. Thus, a hybrid organization is less likely to produce results

[10] FannieMae and Freddie Mac are two of the best-known GSEs in the U.S. They are mortgage finance corporations traded on the New York Stock Exchange. In terms of dollar value of assets, they are two of the largest businesses in the U.S. In addition, other GSEs pursue activities including not only housing, but also agriculture and education (Koppell, 2003).

consistent with the goals of the political principal than are traditional bureaucratic agencies.

Viewed as a whole, scholarly conclusions that political control of the bureaucracy is possible are predicated on the ability of elected officials to design bureaucratic organizations in such a way that bureaucratic discretion is limited before policy implementation begins, or at the least, effective monitoring and regulatory activities are possible. A political principal may, however, be faced with managing a working relationship with a bureau that he or she did not create or oversight of a policy that is already in implementation phase. Further, monitoring and regulatory activities may be costly. The ameliorating factor in all of this may be that the elected official and the bureaucrat may have a shared interest in serving the public. A similar goal on the part of principal and agent may reduce the problems associated with the principal-agent relationship (Eisenhardt, 1985).

Goal congruence may at least in part explain the results found by Milward and Provan (2000) regarding the positive effect of long-term working relationships on agency outcomes. The authors' application of agency theory to issues of public administration relies on the analysis of community mental health networks. These networks are made up of government agencies at the state and local level, as well as nonprofit organizations (Milward & Provan, 1998; 1995). It may be reasonable to believe

the organizations making up these networks share the goal of improved mental health among those served.

Quasi-governmental agents represent a move away from a purely public agent carrying out the directives of a political principal. The observed level of responsiveness to the political principal appears to diminish as the agent moves away from the traditional government agency organizational form. The lower level of responsiveness on the part of the hybrid agent may be at least in part attributable to a potential for divergence between the principal and agent with regard to commitment to the public interest. The hybrid's motivation to substitute other goals for the public interest may be exacerbated in cases such as FannieMae and Freddie Mac, where the hybrids may be more responsive to the preferences of their stockholders than to their political principals and the public interest.

Once a wholly private-sector agent is introduced into the implementation process, the challenges wrought by differing goals and levels of commitment to the public interest are likely to be significantly amplified. Further, the control mechanisms arising from organizational design and the direct employment relationship existing between elected official and bureaucratic subordinate disappear. The remaining alternatives are policy design and regulatory solutions. Because New Governance policy design intentionally results in indirect program implementation with a strong

reliance on third-party actors, regulatory solutions may provide the sole means through which appropriate agent behavior can be obtained with these tools.

In summary, traditional applications of principal-agent theory to public administration are not adequate to address the role increasingly played by public organizations (Salamon, 2002a; Waterman & Meier, 1998). Because governments continue to place more reliance on indirect policy tools to address public problems, third-party actors play an ever-expanding role in policy implementation. As a result, public organizations face a growing role as principals managing relationships with third-party agents (Salamon, 2002a; Kettl, 2002b; Milward & Provan, 2000; Kettl, 1993).

Principal-Agent Theory and the Low Income Housing Tax Credit

The principal-agent relationship between state housing agency-principal and developer-agent forms the basis for the analysis contained in this dissertation. However, there are multiple principals and agents in policy implementation, as is typically true for other policies and programs. The description of the wider array of principal-agent relationships in the Low Income Housing Tax Credit program is provided here to highlight the complexities involved with this program's implementation.

The Low Income Housing Tax Credit is a policy tool with multiple principals and agents. Ultimately, citizens are the principal in any public policy implemented in a democratic society. From the perspective of oversight, the Internal Revenue Service is

the principal in this program. However, the broad discretion granted state housing credit agencies and the delegation of all significant aspects of administration—including both the competitive selection process and long-term compliance monitoring—translates into the state housing agencies functioning as the principal most closely involved with managing the behavior of third-party implementation agents.

It is also important to acknowledge that Low Income Housing Tax Credit program implementation relies on a host of third-party actors who are not developers. Tax credit syndicators play an important role in the implementation process, setting the price at which tax credits are sold through an oligopolistic process and monitoring developers' program compliance once a tax credit development has been funded and built.[11] Other third-party actors necessary to implementation include tax attorneys, architects, accountants, environmental experts and property managers. Despite the presence of these actors in the implementation process, they all serve at the pleasure of the tax credit developer who actually competes for program resources. Thus, the developer is principal in a wide range of working relationships with agents necessary to their success in the Low Income Housing Tax Credit program. Viewed in terms of a relationship with the state housing credit agency, the developer is the primary program implementation agent.

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[11] Syndicators perform their own compliance monitoring activities on Low Income Housing Tax Credit developments in order to protect the value of their investment and avoid any potential financial consequences associated with non-compliance.

The four major components of principal-agent theory are applied to the Low Income Housing Tax Credit to provide the basis of analysis for this dissertation. As previously presented, these components include information asymmetry, adverse selection, moral hazard and goal conflict.

Information asymmetry is a factor at the time of the developer's application for tax credit resources, as well as throughout the period during which the property will be legally required to operate with income restrictions. Adverse selection may arise from the condition of information symmetry, because the state housing agency does not know the true qualifications, motivations and goals of developers who apply for project funding. This lack of incomplete information about prospective developer-agents has implications for whether agents most likely to perform in the public interest are selected.

Information asymmetry also means that once a developer-agent is selected, the state housing agency-principal cannot observe the true behavior of developer-agents. This results in moral hazard. For instance, the public organization principal cannot know the true level of profit earned by the developer-agent as a result of program participation, since there are no federal requirements for disclosure of this information. The challenge in determining a developer's true level of profits from housing tax credit participation is compounded by the fact that many tax developers engage in vertical

and horizontal integration, acting as general contractor, developer, and property manager—with profits accruing for each function performed.

In addition, developer-agents may not provide all services or amenities promised during the application process. They may also use tenant-selection policies such as rigid credit history reviews in order to screen out the neediest households, since these households may be perceived as more difficult—and therefore, less profitable—to serve than others.

Empirically, there is support for concerns about the potential for information asymmetry. The General Accounting Office noted in 1997 that "In controlling costs. . .allocating agencies are largely dependent on information submitted by developers. If the agencies do not have complete and reliable information, they are less assured their controls are effective (p. 9)." This description is a prime example of information asymmetry; the developer-agent may very well have information not available to the state housing agency-principal.

Another aspect of information asymmetry is associated with the lack of centralized reporting of detailed information on tenants served. Federal housing programs enacted prior to the Reagan era typically included a requirement that property owners submit detailed tenant demographics, including age, race and ethnicity, household size and income (Olsen, 2003). While developer-agents in the Low Income Housing Tax Credit program are periodically monitored by state housing

agency-principals for compliance with tenant income certification procedures and tenant selection policies, collection of detailed data on each tenant household is not required. Thus, no centralized source for complete information on tenants is available at either the state or federal levels. This dramatically reduces the evaluability of the program, making it difficult if not impossible to assess program outcomes. The limited evaluability of the Low Income Housing Tax Credit may increase the potential for moral hazard among developer-agents.

There is a very strong potential for goal conflict between principal and agent in implementing the Low Income Housing Tax Credit. The strength of this potential arises from divergence of interests between the public principal and the private agent. The state housing agency-principal has been established to fulfill a public purpose, regardless of whether it exists in the form of a traditional government agency or public authority. In contrast, approximately 80 percent of the developer-agents participating in the Low Income Housing Tax Credit program are for-profit entities.[12] The purpose of a for-profit firm is to maximize shareholder wealth (Brigham & Erhardt, 2003; Samuelson & Nordhaus, 1995). Thus, there is an immediate and powerful divergence of goals between principal and agent in Low Income Housing Tax Credit implementation.

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[12] Analysis of limited data collected from the states by the U.S. Department of Housing and Urban Development indicates that 80 percent of the units developed with the Low Income Housing Tax Credit from 1987 through 2003 were developed by for-profit organizations. Dataset available at http://lihtc.huduser.org/.

How may the public principal ameliorate the potential for developer-agents to exploit information asymmetries to achieve their goals at the expense of the principal's goal? As previously presented, the principal's solution is theoretically rooted in hierarchy (Williamson, 1996; 1975; Miller, 1992). The application of hierarchy to the principal-agent relationship in the Low Income Housing Tax Credit is more complex than situations where a principal and an agent are engaged in a formal employment arrangement with clear superior-subordinate roles. Rather, the public organization principal is faced with a need to introduce hierarchy into a network of organizations over which it has no formal authority or control, such as that described by Moynihan (2005) and Milward and Provan (2000; 1998).

The hierarchical network may be created by introduction of a management control system based on regulatory control tools, such as those described by Ekanayake (2004), Koppell (2003) and Mitnick (1980). The regulatory control tools have the purpose of structuring rewards and sanctions in a manner designed to induce desired behavior on the part of developer-agents.

The decentralized and competitive quasi-market policy design of the Low Income Housing Tax Credit translates into a competitive arena for resources within each state. Each state's competitive arena is structured by the annual Qualified Allocation Plan, which sets forth state housing policy priorities and the competitive selection system.

It is important to note that within any given state, significant barriers to entry by potential agents may exist; these barriers are likely to arise through economies of scale. Smaller, community-based developers—both for-profit and nonprofit—are less likely to have the resources to withstand the stiff competition found in the costly and lengthy pre-application and selection processes. In addition, barriers to entry may exist in many states in the form of requirements for previous experience in the Low Income Housing Tax Credit program. Those with other types of development experience (or as frequently is the case with nonprofits, no development experience) are either unable to compete in that arena or must find a partner with experience deemed appropriate by the state housing agency-principal.

The barriers to entry in the state competitive arena for tax credit resources may create a situation where the public organization principal has unwittingly fostered dominance of the process by a small group of the largest and most influential developer-agents. Domination of the competitive arena by the largest and most influential developer-agents may well give them the power to gain the "upper hand" described by Salamon (2002a, p. 12). This developer-agent advantage may also result in organized efforts to influence the political process, similar to efforts described by Milward and Provan (2000) related to community mental health network functioning.

States have broad discretion in this program's implementation, however. They are free to structure the competitive arena with minimal constraints associated with

federal regulations. Active efforts to structure a competitive arena allowing greater participation by organizations with lower levels of financial and staff capacity have been empirically shown to be possible by Collins and Gerber (2006) in their analysis of local government competition for federal Community Development Block Grant funds administered by the states.

Conclusion

The Low Income Housing Tax Credit is an indirect tool of public action characteristic of the New Governance. Its policy design devolves significant responsibility for competitive program administration and long-term compliance monitoring to state housing credit agencies. As the public organizations most closely involved with policy implementation, these agencies serve as principals. By Congressional design, state housing-agency principals must work closely with private-sector developer-agents to distribute program resources for the construction or substantial rehabilitation of rental dwellings for low-income households. One of the primary challenges facing this group of public organization principals is the fact that their own goals are embedded in serving the public interest, while the goal of the majority of the developers participating in program implementation is profit maximization. This sets the stage for a competitive arena for program resources fraught with challenges inherent in the principal-agent model associated with information asymmetry, adverse selection, moral hazard and goal conflict.

Regression analysis and multiple case studies will be used to explore the performance of state housing agency-principals and the issue of excessive profits obtained by developer-agents through participation in the Low Income Housing Tax Credit program. These research methods are described more fully in Chapter 4.

CHAPTER 4

RESEARCH METHODS AND QUANTITATIVE ANALYSIS

Regression analysis and multiple case studies are used to address the complexities inherent in assessing the quality of the principal-agent relationship central to Low Income Housing Tax Credit implementation. The methods are applied in two stages. First, regression analysis highlights the differences among states attributable to observed factors such as time (year), state economic health, conditions in each state's real estate industry, state housing agency organizational features and level of nonprofit program participation. Second, multiple case studies reveal aspects of each state housing agency's conduct of its role as principal vis-à-vis private-sector developer-agents not subject to observation using regression analysis alone.

The research methods are applied to the 48 contiguous states. The non-contiguous states (Hawaii and Alaska) are typically considered strong outliers in matters related to both housing markets and issues of economic development and are therefore omitted from the analysis.[13] The five-year period 2000 through 2004 is used as the time frame for both the regression analysis and case studies.

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[13] For instance, Paul Brace (1994) focused on the 48 contiguous states in his study of state governments and economic performance.

Regression Analysis

As introduced in Chapter 2, the Low Income Housing Tax Credit has been criticized by some scholars as a source of excessive or windfall profits for developers (Olsen, 2000; Orlebeke, 2000; Case, 1991). McClure (2000, p. 101) has asserted that excess profits have been "squeezed out" of the Low Income Housing Tax Credit over the years. This view is contradicted by Jackson (2006), who found no evidence showing units developed with the Low Income Tax Credit would not have been developed without the federal subsidy.[14] The extremely low level of program evaluability found in the Low Income Housing Tax Credit might be construed as compelling a very guarded view regarding any assertions about excessive or windfall profits, regardless of the direction these assertions take.

Given that states have been found to vary widely in the ways in which they structure the competitive arena for tax credit resources (Gustafson & Walker, 2002; General Accounting Office, 1997), it may be reasonable to assume that their effectiveness as principals also varies. In light of the limited information available about program implementation, how is it possible to measure differences in performance among state housing agency-principals? One means is to empirically examine the assertion of long-time housing economist Edgar Olsen (2000), who stated that "developers have requested three times as much money as state housing agencies have

[14] If the housing units would have been developed without subsidy, then the presence of the subsidy would increase the profitability of development, all other things being equal.

to allocate under the LIHTC [Low Income Housing Tax Credit]" and that the "reason. . .there is an excess demand for program funds by suppliers of housing is that those who are allowed to participate make excessive profits (p. 7)."

Olsen's statement regarding the Low Income Housing Tax Credit program and excess profits provides the basis for constructing a rough proxy of the availability of excessive profits, since information on the true level of profits accruing to developers who participate in the program is unknown. The connection between requests totaling three times as much money as available and Olsen's interpretation that this is evidence of excessive profits being obtained by developer-agents in the Low Income Housing Tax Credit program relies on economic assumptions about the competitive market and the signaling concept. Under the assumptions related to competitive markets, excessive profits may only be obtained when market information is imperfect; in other words, information asymmetries exist and these asymmetries are exploited by certain market participants (Samuelson & Nordhaus, 1995).

The concept of signaling rests on the use of an observable phenomenon as a proxy for an underlying condition. Signals have been used as proxies in the literature on principals and agents for purposes as diverse as employee selection, assessment of bank management quality in the regulatory process, and the communication of policy preferences by elected officials (Spence, 1973; Krainer & Lopez, 2003; Worsham and Gattrell, 2005). In the case of the Low Income Housing Tax Credit, Olsen's observation

that developer-agents regularly request three times the resources available can be interpreted as a signal that excessive or windfall profits are being obtained by developer-agents in program implementation.

Olsen's assertion regarding the magnitude of excess requests for tax credit resources is global in nature; it does not acknowledge that excess requests—and therefore, the perceived ability of developers to capture excess profits—are not likely to be uniform across the states. Table 2 provides information on the level of excess requests for the Low Income Housing Tax Credit in the 48 contiguous states for the year 2000.

Table 2
Requests for the Low Income Housing Tax Credit, 2000

STATE	AVAILABLE RESOURCES (IN DOLLARS)	RESOURCES REQUESTED (IN DOLLARS)	REQUESTS AS % OF AVAILABLE RESOURCES
AL	5,658,332	21,264,561	375.81%
AZ	6,928,748	12,484,218	180.18%
AR	3,189,216	8,737,048	273.96%
CA	51,139,883	175,873,963	343.91%
CO	5,113,134	7,883,781	154.19%
CT	4,344,106	6,211,553	142.99%
DE	945,590	2,595,101	274.44%
FL	19,137,960	73,392,691	383.49%
GA	10,494,505	31,053,151	295.90%
ID	1,720,146	5,162,825	300.14%
IL	14,568,715	45,477,795	312.16%
IN	8,010,402	14,473,255	180.68%
IA	3,610,809	8,959,013	248.12%
KS	4,595,145	15,281,085	332.55%
KY	7,093,492	18,111,622	255.33%
LA	6,821,622	16,991,516	249.08%
ME	1,772,300	3,080,661	173.82%

STATE	AVAILABLE RESOURCES (IN DOLLARS)	RESOURCES REQUESTED (IN DOLLARS)	REQUESTS AS % OF AVAILABLE RESOURCES
MD	7,201,888	18,270,557	253.69%
MA	8,200,071	27,201,840	331.73%
MI	14,571,973	42,607,299	292.39%
MN	6,185,175	12,391,420	200.34%
MS	3,771,013	13,865,797	367.69%
MO	6,942,374	23,374,697	336.70%
MT	1,144,262	3,379,670	295.36%
NE	2,312,775	6,720,930	290.60%
NV	2,280,910	5,343,928	234.29%
NH	1,516,731	1,851,459	122.07%
NJ	10,310,857	17,759,587	172.24%
NM	2,181,905	4,200,000	192.49%
NY	23,562,813	71,980,000	305.48%
NC	10,201,469	14,254,025	139.73%
ND	1,301,413	2,751,186	211.40%
OH	14,166,872	35,079,708	247.62%
OK	4,567,581	9,683,282	212.00%
OR	4,224,377	9,540,770	225.85%
PA	17,003,914	33,000,000	194.07%
RI	1,792,149	4,084,155	227.89%
SC	5,485,431	20,654,393	376.53%
SD	1,103,776	1,744,391	158.04%
TN	7,398,940	19,428,941	262.59%
TX	25,667,708	115,896,296	451.53%
UT	2,863,542	6,136,000	214.28%
VT	748,752	2,192,942	292.88%
VA	9,285,139	18,662,450	200.99%
WA	8,553,559	13,606,037	159.07%
WV	2,269,408	2,930,154	129.12%
WI	6,679,173	22,208,428	332.50%
WY	725,890	1,518,468	209.19%
		Minimum	122.07%
		Maximum	451.53%
		Mean	252.44%
		Median	248.60%
		Standard Deviation	77.36%

Source: Author calculations based on data published by the National Council of State Housing Agencies, 2001.

Although Olsen's statement that developers regularly request three times the dollars actually available under the Low Income Housing Tax Credit program indicates a value somewhat higher than that shown by an analysis of program data for the year 2000, the data do show that on average, developers requested more than two and one-half times the actual resources available. Further, there is wide variation in requests as a percentage of available resources, ranging from a low of 122.07 percent in New Hampshire to a high of 451.53 percent in Texas. The standard deviation for requests as a percentage of available resources was 77.36 percent.

Data presented in Table 2 provide support for the proposition that state housing agency-principals vary widely in their effectiveness in managing their relationships with developer-agents. Some of the variations may arise from the relative desirability of a state for development, such as those associated with a growing population, high per capita incomes, and other issues affecting the market for housing in an individual state. However, variations among the states may also be driven by differences in management practices and the structure of the competitive arena for resources.

Dependent Variable

The regression model's dependent variable is excess requests for Low Income Housing Tax Credit resources. This variable is based on Olsen's (2000) assertion that large excess requests for tax credit resources are indicative of the ability of developer-agents to obtain excessive or windfall profits through program participation. The

dependent variable was calculated as requests for Low Income Housing Tax Credit resources in each state as a percentage of total available resources (requests for resources divided by total available resources).

Data were available for each of the 48 states for each of the years 2000 through 2004, with the exception of two missing observations related to dollar value of Low Income Housing Tax Credits requested. Illinois's observation for dollar value of Low Income Housing Tax Credit requests was missing for 2000. A proxy for this value was calculated by averaging the values for 2001 and 2002. Iowa's dollar value for Low Income Housing Tax Credits requested was missing for 2001. A proxy was calculated by averaging the values for 2000 and 2002.

Independent Variables

Independent variables were selected to represent observable factors such as time (year), state economic health, conditions in each state's real estate industry, state housing agency organizational features and level of nonprofit participation in the program. The regression model equation is:

$$Y = a - b_1(\text{Year 2001}) - b_2(\text{Year 2002}) - b_3(\text{Year 2003}) + b_4(\text{Year 2004}) + b_5(\text{State GDP per 1,000}) + b_6(\text{House Price Index}) - b_7(\text{Construction Value per 1,000}) + b_8(\text{Public Authority}) - b_9(\text{Gubernatorial Supervision}) - b_{10}(\text{Nonprofit Participation}) + e$$

The dependent variable, Y, is the ratio of tax credits requested to tax credits available. Independent variables are summarized in Table 3, and a detailed description of each variable is also provided in the text.

Years 2001 through 2004. The federal per capita allocation to the states increased from $1.25 per capita to $1.50 in 2001. This was followed by an increase to $1.75 per capita in 2002; the per capita allocation increased at the rate of inflation (as measured by the Consumer Price Index produced by the Bureau of Labor Statistics) each year thereafter. These dummy variables are expected to have a negative relationship with the dependent variable, as the availability of more program funding might reasonably be expected to produce lower levels of excess requests. The year 2000 was used as the baseline year and does not appear as part of the model.

Table 3
Regression Model Variables

DEPENDENT VARIABLE: EXCESS REQUESTS FOR TAX CREDITS AS PERCENTAGE OF AVAILABLE TAX CREDITS (Source: National Council of State Housing Agencies)		
Independent Variable	**Expected Effect**	**Description (Data Source)**
Year 2001[15]	-	Dummy variable for year
Year 2002	-	Dummy variable for year
Year 2003	-	Dummy variable for year
Year 2004	-	Dummy variable for year
State Gross Domestic Product (GDP) per 1,000 population	+	Comprehensive measure of economic activity in state scaled for population (Bureau of Economic Analysis)
House Price Index	+	Measure of housing price increases based upon repeated-sales data for individual single-family houses (Office of Federal Housing Enterprise Oversight)
Construction Value per 1,000 population	-	Dollar value of new construction activities scaled for population (U. S. Census Bureau)
Public Authority	+	Dummy variable denoting whether state housing agency is a public authority or a traditional state agency (National Council of State Housing Agencies)
Gubernatorial Supervision	- or +	Dummy variable denoting whether state housing agency is under supervision of governor (National Council of State Housing Agencies)
Nonprofit Participation	-	Nonprofit units developed with Low Income Housing Tax Credit in a given year expressed as a percentage of total units (National Council of State Housing Agencies)

[15] Year 2000 was omitted as the baseline year.

State Gross Domestic Product (GDP) per 1,000 Population. State Gross Domestic Product is a comprehensive measure of state economic activity comparable to the U. S. Gross Domestic Product; both measures are produced by the Bureau of Economic Advisors on an annual basis. State GDP is the sum of consumer, business and government spending, plus investment and net foreign trade (Bureau of Economic Advisors, 2007). GDP was scaled by 1,000 population in order to make the measure a relative comparison of economic activity based on state population for each year during the period 2000 through 2004.

All other things being equal, greater economic health within a particular state would likely make it more attractive for property development activities. As a representation of state economic health, state GDP was expected to be positively related to the dependent variable.

House Price Index. The House Price Index is produced quarterly and annually by the Office of Federal Housing Enterprise Oversight. The index is a robust measure of house price movements representing changes in the price of single-family houses. The index is constructed through repeated measures of sales of individual houses (Office of Federal Housing Enterprise Oversight, 2007).

In the context of the regression model, the House Price Index provides an indication of price escalation within each state in each year within the five-year period 2000 through 2004. A positive relationship between the House Price Index and the

dependent variable was expected, since increasing prices within the market for housing for sale typically foreshadow rising rents. Rising rents could reasonably be expected to produce a greater need for rental housing for lower-income households such as those served by the Low Income Housing Tax Credit program.

Construction Value per 1,000 Population. This variable is based on the reported dollar value of new construction activities in the states released by the U. S. Census Bureau each year. As with the annual state GDP figure, the dollar value of new construction activities was scaled for population so that a relative measure of construction activity could be produced for each year in the study period, 2000 through 2004. Construction value per 1,000 population was expected to have a negative relationship with the dependent variable, in that the greater the value of construction activity within the state, the greater the opportunities for construction companies and developers to pursue business opportunities without the reliance on public programs.

Public Authority. Public authorities are frequently viewed as operating outside the visibility of general government, with a concomitant lack of accountability (Axelrod, 1992). Many state housing agencies have been formed as public authorities. Information on each state housing agency's form of organization was obtained from secondary data made available by the National Council of State Housing Agencies.

Since public authorities tend to operate with less public oversight than traditional state agencies, it was expected that developer-agents would have a

preference for working with those state housing agencies with the public authority organizational form. With less public oversight of the public principal, it might be reasonable to assume that developer-agents could exert more influence over housing policy priorities and program administration. Therefore, the expected relationship between the dependent variable and the public authority independent variable was positive.

Gubernatorial Supervision. Data made available by the National Council of State Housing Agencies indicate that states vary as to whether there is direct supervision of the state housing agency by the governor. Further, state housing agencies with the public authority form of organization are not necessarily without gubernatorial supervision, while those with traditional state agencies fulfilling the role of state housing agency are not necessarily under gubernatorial supervision. As a dummy variable, gubernatorial supervision represents a dichotomy—its value is either one or zero in the regression analysis. However, it is important to recognize that states reporting direct supervision of the state housing agency by the governor will likely vary along a continuum in terms of the extent and type of gubernatorial involvement and oversight provided.

Gubernatorial supervision may have either a positive or negative coefficient. In one view, gubernatorial supervision may indicate that with an elected representative of the citizens overseeing the state housing agency and its activities, the expected

relationship between the dependent variable and gubernatorial supervision is negative. In other words, political oversight can be seen to improve the effectiveness of the state housing agency's implementation activities. In another view, as an elected representative, the governor may be most interested in re-election. This view would be interpreted as providing a positive relationship between the dependent variable and gubernatorial supervision, since the governor's concern with re-election may translate into a willingness to influence the tax credit implementation process in favor of political contributors who are also members of the development industry.

Nonprofit Participation. The percentage of units developed by nonprofit development organizations with the Low Income Housing Tax Credit varies considerably from state to state and from year to year. Data for each year within the period 2000 through 2004 were obtained from the National Council of State Housing Agencies, with the exception of nonprofit participation for Arizona in 2002. A proxy for this missing observation was calculated by averaging the nonprofit participation values for 2001 and 2003.

As entities created to serve a public purpose, nonprofit housing organizations may have goals more congruent with those of state housing agencies than are those of their for-profit counterparts. Therefore, the greater the level of nonprofit participation in a state's Low Income Housing Tax Credit competitive arena, the lower the likelihood that for-profit developers may exploit market imperfections and gain excess profits.

Thus, the expected relationship between the dependent variable and nonprofit participation is negative.

Regression Results

Table 4 presents descriptive statistics for the dependent and independent variables.

Table 4
Descriptive Statistics

	Mean	Standard Deviation	N
REQUESTS FOR RESOURCES	206.28	77.73	240
YEAR2001	.20	.40	240
YEAR2002	.20	.40	240
YEAR2003	.20	.40	240
YEAR2004	.20	.40	240
NONPROFIT PARTICIPATION	32.66	23.21	240
HOUSE PRICE INDEX	7.22	4.16	240
CONSTRUCTION VALUE PER 1,000	775.29	399.95	240
GDP PER 1,000	35.02	6.51	240
PUBLIC AUTHORITY	.68	.47	240
GUBERNATORIAL SUPERVISION	.29	.46	240

The mean value of the dependent variable, requests for Low Income Housing Tax Credit resources expressed as a percentage of total available resources, was 206.28, with a standard deviation of 77.73 and *N* equal to 240. The mean value of nonprofit participation was 32.66 percent, with a standard deviation of 23.21 percent and *N* equal

to 240. The mean value for house price index was 7.21 percent, with a standard deviation of 4.15 percent and *N* equal to 240. The mean dollar value of new construction per 1,000 population was $775.29, with a standard deviation of $399.94 and *N* equal to 240. Finally, mean per capita income was $29,854.20, with a standard deviation of $4,574.42 and *N* equal to 240.

Table 5 presents regression model results. Variable significance was interpreted using one-tailed tests, since the direction of the effect of each independent variable was anticipated prior to model execution.

Table 5
Regression Model Results

CONSTANT/VARIABLE	UNSTANDARDIZED REGRESSION COEFFICIENT	STANDARD ERROR	SIGNIFICANCE (P-VALUE)
Constant	276.224	30.641	.000
Year 2001	-39.632	14.755	.004
Year 2002	-63.350	14.898	.000
Year 2003	-56.110	15.209	.000
Year 2004	-55.797	16.171	.000
NONPROFIT PARTICIPATION	-.366	.207	.040
HOUSE PRICE INDEX	.015	1.341	.991
CONSTRUCTION VALUE PER 1,000	-.021	.013	.050
GDP PER 1,000	-.600	.850	.241
PUBLIC AUTHORITY	12.735	12.433	.154
GUBERNATORIAL SUPERVISION	47.165	12.913	.000
Model R-squared = .174 *N = 240* A one-tailed significance test was used for all independent variables with the exception of gubernatorial supervision, since the direction of the variables' impact was predicted prior to running the regression analysis.			

Source: Author calculations using SPSS.

Seven of the ten independent variables were statistically significant at the 95 percent level. Significance was determined using a one-tailed test ($p < .10$) for all independent variables except gubernatorial supervision. A two-tailed test ($p < .05$) was used to interpret results for this variable, since the direction of the effect might arguably be either negative or positive. The model's R-squared was .174, while the standard error was 72.160.

The dummy variables for years in this model showed a slightly negative effect on excess developer-agent requests for funding under the tax credit program. This may be associated with the increase in state allocations announced in late 2000; the per capita allocation of tax credits rose above $1.25 in 2001 for the first time since program implementation began in 1987 and continued to rise thereafter.

Opportunities for construction and development as measured by the dollar value of new construction per 1,000 within each state for each year showed a slightly negative effect on excess requests for program resources. This is consistent with the reasoning that the presence of greater opportunities for new construction and development would lead to somewhat lesser interest in development relying on public resources and requiring relatively long periods during which income restrictions would apply to units developed with the program.

Gubernatorial supervision was found to have a positive relationship with the dependent variable, excess requests for housing tax credit resources. This may be

interpreted as providing a greater opportunity for political influence in the selection of developments to be funded with the Low Income Housing Tax Credit; thus, gubernatorial supervision does not reduce excess requests by providing centralized oversight of the housing agency, but rather provides an access point for the exercise of political influence by developer-agents.

Nonprofit participation in the Low Income Housing Tax Credit program had a slightly negative effect on the dependent variable. This coefficient is in the expected direction, since greater nonprofit participation may be interpreted as greater participation by organizations with goals more congruent with the public policy priorities of the state housing agencies than their for-profit counterparts. Nonprofit organizations must by definition serve a public purpose (Bryce, 2005). Therefore, the relative level of success of nonprofit agents in a state's competitive arena for tax credits may indicate that arena is structured in a way that more effectively aligns the goals of developer-agents with those of the public principal.

The robustness of the market for housing as expressed by the federal House Price Index did not have a significant effect on developer requests for tax credit resources. Further, the relative economic health of the state expressed as State Gross Domestic Product was not significant. Finally, the public authority form of organization for state housing agencies was not significant in this analysis.

Linking Regression Results with Case Studies

The low R-squared (.174) obtained with the regression model indicates a high level of unexplained variation among the states in terms of the quality of the relationship between state housing agency-principals and developer-agents in Low Income Housing Tax Credit implementation. The quality of the principal-agent relationship was assessed for each state across time by calculation of predicted and observed values for the dependent variable, requests for tax credit resources as a percentage of total available resources. Observed values for the dependent variable were subtracted from values predicted by the model; the difference between the predicted and observed values yielded a residual for each state for each year. Large negative residuals (those found below the line predicted by the model) indicate states that perform better than predicted, while large positive residuals (those found above the line predicted by the model) indicate states that performed more poorly than predicted.

Those states with large negative residuals were interpreted as more effective principals than those with large positive residuals. This interpretation is based on the assumption that states with large negative residuals have structured their working relationships with agents in ways that reduce agents' potential to capture excessive or windfall profits. States with large positive residuals may have working relationships

with agents that leads to at least a perception among agents that excessive or windfall profits are possible in that state.

The regression model provided a residual for each state for each of the five years forming the time horizon for this research. In order to assess the performance of the states for the period as a whole, an average residual was calculated for each state. The average residuals appear in Table 6. Results are reported in order from largest negative to largest positive average residuals.

Table 6
Average State Residuals, 2000-2004

STATE	AVERAGE RESIDUAL 2000-2004
ND	-110.410818
SD	-84.098652
WV	-79.008465
NV	-60.182920
CT	-59.567100
TN	-45.913333
WA	-44.597892
CO	-44.536774
OK	-41.507370
IA	-34.793027
NM	-28.783800
AR	-27.984213
MD	-27.620754
PA	-27.289944
NH	-26.009290
VA	-23.834080
WY	-21.560410
DE	-19.381337
OR	-16.689522
OH	-15.097748
NJ	-13.853064

STATE	AVERAGE RESIDUAL 2000-2004
GA	-12.015199
NE	-11.649441
ME	-10.525156
VT	-8.915986
UT	-6.739955
MT	-6.721703
MS	0.177125
SC	1.438970
ID	2.394354
LA	6.366036
KY	10.183738
IN	11.574388
MI	15.341923
MA	19.478589
AZ	31.014248
WI	32.391715
RI	33.151061
FL	40.689905
NC	40.768988
MN	43.870672
NY	51.513532
MO	69.838058
CA	85.642035
KS	86.057542
TX	98.808181
IL	99.758705
AL	128.828189

Four case study states were chosen for in-depth analysis based on the calculation of average residuals across time. The two states with the largest negative residuals were North Dakota and South Dakota, with respective average residuals of approximately -110.41 and -84.10. These states were chosen to represent those who performed better than the regression model predicted in the case study analyses.

The states chosen to represent those with large positive residuals relied on a two-step process due to the idiosyncratic presence of two state housing credit agencies in the state of Illinois, the state with the second highest average residual for the study period. Owing to the sole exception to the federal rule that there be only one state housing credit agency designated in each state (Solem, 1987), Chicago operates a separate housing credit agency from the rest of the state. This separation is likely to make Illinois an outlier in terms of the types of managerial challenges and strategies it employs. Therefore, it was not included as a case study state. With the omission of Illinois, Alabama and Texas were the two states with the largest positive average residuals and were selected to represent states that performed more poorly than predicted in the case study analyses.

Case Studies

Yin (2003) described the case study as "a distinctive form of inquiry" rather than simply an application of qualitative methods (p. 10)." The goal of the case study is to expand and generalize theories. The case study method is more formally defined as "an empirical inquiry that investigates a contemporary phenomenon within its real-life context," particularly when "the boundaries between phenomenon and context are not clearly evident (p.13)." Thus, the case study method facilitates analysis of phenomena while retaining their context, resulting in "an all-encompassing method—covering the

logic of design, data collection techniques, and specific approaches to data analysis (p. 14)."

Case studies allow retention of holistic information useful in the study of numerous empirical events, including organizational and managerial processes (Yin, 2003). Further case studies are especially appropriate for the capture of local differences in the implementation of larger programs (Patton, 1987).

Case studies may be descriptive, exploratory or explanatory. The exploratory approach is particularly useful when an intervention is being evaluated that does not have a single and clear set of outcomes (Yin, 2003; p. 15). Given the complexity of Low Income Housing Tax Credit policy implementation and the low level of explanatory power found in regression analysis of the program, an exploratory focus was chosen to address the case studies included in this research.

Multiple case study states were chosen in this study of how public organization principals manage relationships with private-sector agents not only in the hopes of producing opportunities for replication across states, but also for the exploration of differences arising from the context in which implementation occurs. Multiple sources of information were used in the case studies in an effort to produce data triangulation. Data triangulation involves the use of multiple sources of evidence to produce a research design more powerful than may be obtained with a single data source. The strength in the research design arises from combining the strengths of various data

sources to ameliorate deficiencies that might be found in any one data source (Yin, 2003; Patton, 1987). Results of the regression analysis, secondary data, document analysis and interviews were relied on in the case study research forming a part of this dissertation.

Secondary data were used to provide information on state demographics and economic health; the sources for these data were the U. S. Census Bureau and the Bureau of Economic Advisors. Secondary data regarding state housing agency staffing, budgets and program outputs were obtained through publications of the National Council of State Housing Finance Agencies (2005; 2004; 2003; 2002; 2001).

Document analysis primarily focused on each state's Qualified Allocation Plan for the five-year period 2000 through 2004. These allocation plans have been part of federal requirements since 1990, and they are required to provide detailed information on housing policy priorities and the criteria for selecting applications to be funded. Thus, these documents provide a centralized source of information on managerial strategies, as well as on policy priorities.

The primary document analysis was supplemented by analysis of other documents, including housing agency annual reports, organization charts or other materials referencing each agency's hierarchical structure and documents containing information on specific developments funded during the period 2000 through 2004.

Interviews provided the final data source for this research; they were conducted after the analysis of secondary data and documents had been performed. These

interviews were structured using the standardized open-ended interview technique. This technique facilitates the systematic collection of information from interviewees (Patton, 1987). The drawback of this interview technique is that it reduces flexibility and spontaneity (Patton, 1987). The last question of the interviews was intentionally made open-ended in an effort to introduce an opportunity for such flexibility and spontaneity into the interview process.

Interviews were sought with three members of management within each housing agency—the executive director, the tax credit manager and the compliance manager.[16] State housing agency interviewees are not identified by name in this research, although their positions within the organization are. Interviews were also sought with two developers in each state, one nonprofit and one for-profit. The names of developers who agreed to be interviewed have been kept confidential. Further, developers who have participated in the Low Income Housing Tax Credit program in each state were identified by reference to publicly available lists of developments funded. Therefore, there was no risk that state housing agency management could identify respondents or steer the interviewer towards any particular developer.

Alabama's executive director agreed to respond to interview questions, but required that the questions be posed in writing. These written results have been combined with results of other interviews in the case study process. Interviews were

[16] With the exception of the executive director, these titles are generalized titles intended to describe the function performed by each individual. Actual titles varied across states.

also conducted with Alabama's development administrator (with overall responsibility for the tax credit program) and compliance coordinator.

North Dakota's executive director agreed to be interviewed, but requested that his agency's director of development and planning be included in the interview. He stated that his request was made owing to his expertise being in single-family homeownership programs rather than multifamily rental development. Thus, for North Dakota the interview with the executive director and the person directly responsible for management of the Low Income Housing Tax Credit was combined. North Dakota's executive director declined to allow a separate or additional interview with the compliance manager.

South Dakota's executive director delegated the interview to his agency's director of rental housing development. This individual served as the agency's tax credit manager until her promotion in late 2006. At that time, the agency's staff was expanded, and she was given responsibility for all rental housing programs, including the Low Income Housing Tax Credit. An interview was also conducted with the compliance management officer responsible for tax credit program compliance.

In Texas, interviews were conducted with the multifamily housing program director and compliance manager. The executive director was unavailable for interview.

Questions used in interviews with state housing agency managers are shown in Figure 1.

Figure 1
State Housing Finance Agency
Preliminary Interview Questions

1. Does the governor get involved with state housing policy issues or the management of the Low Income Housing Tax Credit program? If so, how?
2. What kinds of decisions need approval from upper level management? From the board? From the governor?
3. How does your agency seek public input in developing each year's Qualified Allocation Plan?
4. Have you had turnover in key staff or management positions in the last five years? If so, how has this affected the level of expertise available within the agency to address management issues that arise with the Low Income Housing Tax Credit program?
5. If your state agency uses formal methods for identifying housing need in different geographic areas of the state, how did this come about? If your state agency does not use a formal method for identifying housing need, has there been any discussion of using such methods?
6. If your state housing finance agency uses selection criteria that include a focus on housing for extremely low income households, how were these criteria introduced into your Qualified Allocation Plan? If your state housing finance agency does not include a selection preference for extremely low income housing, has there been any discussion of including it?
7. Can you describe in general how your agency handles subsidy layer reviews?
8. Does your agency do any capacity building with nonprofit housing organizations? If so, what does your agency do? If not, is there any other entity within your state that works to build nonprofit housing capacity?
9. Are compliance activities handled by in-house staff?
10. How flexible is your agency in enforcing Low Income Housing Tax Credit compliance requirements?
11. What is the process for following up on instances of developer non-compliance in your state?
12. Is there any information you would like to add about how your agency administers the Low Income Housing Tax Credit?

Two Alabama developers were interviewed—one with a nonprofit organization and one with a for-profit organization. One South Dakota for-profit developer was interviewed; attempts to interview a nonprofit developer in that state were unsuccessful. No responses were obtained from North Dakota developers, while responses from both for-profit and nonprofit developers were obtained in Texas.

The questionnaire used to guide the interviews with developers is shown in Figure 2.

Figure 2
Developers
Preliminary Interview Questions

1. How much involvement does the governor have in housing policy in this state? Does any of this involvement specifically include the Low Income Housing Tax Credit program?
2. When you work with staff from the state housing finance agency, who has the authority to make decisions on matters that arise in the application process? The underwriting process? The compliance process?
3. How experienced is the state housing agency staff? How does this affect your work with the agency?
4. What makes some geographic areas of the states more attractive than others for the purpose of development using Low Income Tax Credit funding?
5. Does your organization develop any housing that targets extremely low income households?
6. How much involvement do nonprofit housing organizations have in developing housing policy priorities and selection criteria for each year's Qualified Allocation Plan in this state?
7. Does the state housing finance agency consider developers' past administrative responsiveness or program compliance in deciding which projects will be funded?
8. Do developers directly commission market studies for tax credit developments in your state?
9. Are there any unit cost limitations placed on tax credit developments in your state?
10. What can you tell me about the subsidy layer review process?
11. If your state housing finance agency engages in nonprofit housing organization capacity-building efforts, what affect do you feel these efforts have on the annual competition for Low Income Housing Tax Credits?
12. What is the tax credit compliance process like in your state?
13. Is there any information you would like to add about your organization's work with the Low Income Housing Tax Credit program and your state housing finance agency?

As presented in Chapter 3, hierarchy has been offered by various scholars as a solution to the challenges inherent in the principal-agent relationship (Milward &

Provan, 1998; Waterman & Meier, 1998; Miller, 1992; Eisenhardt, 1989; 1985; Williamson, 1996; 1975). Once information from the multiple data sources described above were collected for each state, they were organized and interpreted based on how they might affect the ability of the public organization principal to foster a hierarchical relationship with the private-sector agents making up each state's implementation network.

Chapter 5 provides case study analysis of North Dakota and South Dakota, states that performed better than predicted in Low Income Housing Tax Credit program implementation. Chapter 6 includes case studies of Alabama and Texas, states that performed more poorly than predicted in the tax credit program.

CHAPTER 5

STATES PERFORMING BETTER THAN PREDICTED

This chapter provides an analysis of two states that performed better than predicted in the Low Income Housing Tax Credit implementation process. As presented in Chapter 4, states with the largest negative residuals were interpreted as states more effective in reducing the capacity for developers to capture windfall profits through the program than are states with large positive residuals. The two states with the largest negative residuals were North Dakota and South Dakota.

The case studies in this and the following chapter are exploratory in nature. Their purpose is to explore differences and similarities in the organizational and managerial processes of states in the implementation of a highly complex and indirect public policy, the Low Income Housing Tax Credit. Based on reasoning presented in the analytical framework of this dissertation, the public organizations treated by these case studies will be examined for factors that may contribute to their ability to introduce and maintain an appropriate level of hierarchy within an implementation network dependent on private-sector agents.

North Dakota

North Dakota's estimated population for 2004 was 635,848; it grew by a scant 0.5 percent between 1990 and 2000. Further, its population density of 9.2 persons per

square mile makes it one of the least densely populated states in the U.S. (U. S. Census Bureau, 2007).

North Dakota's small population, nearly non-existent growth and low population density have implications for the administration of the Low Income Housing Tax Credit program. A small population has the advantage of making it possible to more fully comprehend the issues of housing need in regions throughout the state than may be possible in more populous states. However, the small population may detract from efforts to create a competitive process for tax credits. A smaller state population offers fewer opportunities for developers, and the number of developers willing to enter into competition for resources in such a state may be very low. A smaller pool of developers may translate into a process dominated by very few firms.

North Dakota's low population density may pose challenges for housing development feasibility, since low-density areas may not generate enough demand for rental housing for financial feasibility, even with a public subsidy in the form of the housing tax credit. This may have the most adverse affect on low-income housing opportunities for rural areas, where the relative need may be great, but population density is especially low.

State Housing Agency Overview

The North Dakota Housing Finance Agency is the officially designated state housing credit agency for North Dakota. Features of this agency are presented in Table 7.

Table 7
North Dakota Housing Finance Agency Overview

FEATURE	DESCRIPTION
Year Created	1982
Public Authority	No
Gubernatorial Supervision	No
Number of Board Members	6
Number of Board Members Appointed by Governor	0
State Legislature Approval of Board Members	No
Governor Appoints Executive Director	No
Board Appoints Executive Director	No
Number of Full-Time Staff	40
Annual Operating Budget (2004)	$4,243,026

Source: National Council of State Housing Agencies (2001, 2002, 2003, 2004, 2005)

The North Dakota Housing Finance Agency was created in 1982 and is a traditional government agency overseen by the Industrial Commission of North Dakota. The Industrial Commission is made up of the governor, the attorney general and agriculture commissioner. The commission is advised by a six-member citizen advisory board. Members of this advisory board include representatives of the real estate industry: home builders, lenders, those involved with manufactured housing and real estate brokers. In addition to representatives of the real estate industry, two

members are appointed to represent homeowners and home buyers. Both of these advisory board members have extensive experience with housing policy and programs. One is a long-time public manager with a public housing authority who also serves on advisory boards for the Federal Home Loan Bank and Fannie Mae. The other representative of homeowners and home buyers is a manager in a nonprofit housing organization.

The executive director is appointed by the North Dakota Industrial Commission. Thus, although the governor does not directly appoint the executive director, it is likely that he or she has significant influence in the choice by virtue of participation in the North Dakota Industrial Commission. There are 40 full-time staff members in the North Dakota Housing Finance Agency; the agency's 2004 operating budget was $4,243,026. The agency engages in a number of activities related to homeownership; therefore, only a portion of the full-time staff and operating budget are devoted to Low Income Housing Tax Credit program implementation.

Table 8 provides information on the tax credit resources available in North Dakota during the period 2000 through 2004, as well as requests for housing tax credits by developers. These requests are presented in dollars and as a percentage of available resources in each year.

Table 8
North Dakota
Annual Tax Credit Availability and Requests, 2000-2004

YEAR	TOTAL TAX CREDITS AVAILABLE (IN DOLLARS)	TAX CREDITS REQUESTED (IN DOLLARS)	TAX CREDITS REQUESTED AS % OF TOTAL AVAILABLE
2000	$1,301,413	$2,751,186	211.40%
2001	2,413,629	3,339,609	138.37%
2002	2,567,169	2,729,182	106.31%
2003	2,367,412	3,291,347	101.01%
2004	3,076,170	2,531,366	82.29%
TOTAL	$11,125,793	$13,742,690	117.20%

Source: National Council of State Housing Agencies (2001, 2002, 2003, 2004, 2005) and author calculations

North Dakota's Low Income Housing Tax Credits available for the period 2000 through 2004 ranged from $1,301,413 to $3,076,170.[17] The total available for the five-year period was $11,125,793. Developer requests for tax credits ranged from a low of $2,531,366 during this period to a high of $3,339,609. Over the five-year period developer requests for tax credits totaled $13,742,690. Once awarded to a developer, housing tax credits may be used on an annual basis for 10 years. Thus, the value of North Dakota's available tax credits for the five-year period was $111,257,930 in nominal dollars (e.g., not adjusted for inflation).

At more than 211 percent, tax credits requested by developers as a percentage of total available resources was highest in 2000, the year prior to an increase in the minimum tax credit allocation for states with small populations. Requests as a

[17] Congress increased the minimum allocation of housing tax credits to small-population states to $2 million beginning with 2001 (Guggenheim, 2003).

percentage of total available resources were lowest in 2004, at slightly more than 82 percent. While the increase in federal resources allocated to small states likely had some immediate effect in decreasing this figure, the impact of organizational structure and managerial practices employed by the state must be explored for potential causal relationships with the low level of unexplained variation found in North Dakota's program implementation.

Organization and Hierarchy

Information on the North Dakota Housing Agency was analyzed with regard to the presence of external hierarchy in the form of gubernatorial supervision, as well as the agency's internal hierarchy and its likely impact on discretionary decision making by public managers. Further, external stakeholder access to the policy process was examined, as well as the level of staff expertise within the state housing agency-principal.

As introduced in this dissertation's analytical framework, hierarchy has been described as reducing problems associated with the principal-agent relationship, including lack of goal congruence between principal and agent (Miller, 1992; Eisenhardt, 1985; Williamson, 1975). As a first step in understanding the level of hierarchy present within the Low Income Housing Tax Credit implementation network, the level of hierarchy associated with the state housing agency itself was examined.

When gubernatorial supervision of the state housing agency is present, the governor is, in effect, the principal's principal. He or she may play a crucial role in determining housing policy priorities and the level of discretion placed in the hands of the agency's public managers. It may be reasonable to expect that oversight by the principal's principal creates a condition of hierarchy that may extend itself to the functioning of the network, thereby reducing the ability of agents to exploit the program for the purpose of gaining windfall profits.

As noted earlier, North Dakota is not directly supervised by its governor, but rather by the North Dakota Industrial Commission. Although the commission is not a large body, the presence of public officials in addition to the governor may decrease the effect of gubernatorial influence on Low Income Housing Tax Credit implementation. The lack of direct gubernatorial supervision and high performance is consistent with regression model results presented in Chapter 4, where gubernatorial supervision was associated with an *increase* in excess requests for program resources by developer-agents. The increase associated with gubernatorial oversight of the state housing agency may be interpreted as decreasing the agency's ability to effectively manage the competitive arena for resources. Thus, the lack of direct gubernatorial supervision of the North Dakota Housing Agency may be a contributing factor to its success in managing the principal-agent relationship.

Hierarchy internal to the state housing agency may also be important, since it is likely to have an effect on how decisions are made and the level of discretion granted to public managers at various levels within the organization. A more hierarchically managed state agency may be more effective than a less hierarchal agency, since strong internal hierarchy may reduce the points of access available to developers through which they can seek to influence the design of the competitive arena for resources and day-to-day decisions on the part of state housing agency managers.

North Dakota showed evidence of a relatively high degree of discretion being placed in the hands of program-level management. The executive director of the North Dakota Housing Agency reported that he is typically responsible for approval of items requiring the exercise of discretion related to deviations from the housing agency's written policies and procedures. He also reported that because his own experience is primarily with single-family homeownership programs, he relies extensively on the recommendations of the director of planning and housing development division in exercising discretion with regard to matters associated with the Low Income Housing Tax Credit program. The director of planning and housing development indicated she has extensive experience with the Low Income Housing Tax Credit, as well as with other public multifamily development programs. The indirect placement of substantial discretion into the hands of the public manager with the greatest programmatic expertise may in part be responsible for the high performance of the agency in

managing relationships with developer-agents. Public managers with appropriate expertise are likely to be more effective in dealing with technical issues raised by developers and are less likely to be persuaded by specious arguments made by developers in an effort to obtain a decision in their favor. Expressed in terms of the principal-agent model, there is less potential for information asymmetry between the principal and the agent when the principal is represented by a public manager with a high level of expertise. Therefore, the level of hierarchy within the state agency may be less important than reliance on bureaucratic expertise in explaining a state's effectiveness.

External stakeholder access to the policy process may be facilitated by higher levels of hierarchy in the implementing agency by providing clear and authoritative information on how citizens and advocates may provide input into the development of state housing policy priorities. During the 2000 through 2004 program implementation period, North Dakota invited public comments on housing policy priorities and the structure of the competitive process throughout the year. In addition, the state housing agency made available the draft Qualified Allocation Plan containing policy priorities and details of the competitive process available on its website each year to facilitate public input. It also held public meetings on the draft plan.[18]

[18] Interviews with North Dakota housing agency officials indicated that beginning with 2006, a town hall meeting system was implemented. The system is intended to increase the degree of public input into the implementation of various programs administered by the North Dakota Housing Agency. However, this particular form of public input took place outside the 2000-2004 period covered by this research.

In addition, the citizen advisory board's composition may provide some level of indirect representation for low-income citizens in the policy implementation process. Two members are professionals whose work revolves around low-income housing on a daily basis. While these professionals are not themselves low-income citizens, their work is likely to make them familiar with the issues facing low-income households and therefore able to represent the issues of those households in the state housing agency's policy and managerial processes.

Managerial Control and Hierarchy

The managerial control systems used by state housing agencies in the case study states were examined for their capacity to foster a sense of hierarchy between these principals and their network of private-sector agents. The level of managerial control exercised by each state was analyzed with regard to management practices related to both the competitive arena and compliance monitoring. As presented in the analytical framework, the competitive arena relates to the concept of adverse selection, while compliance monitoring relates to moral hazard within principal-agent theory.

One facet of managerial control available to state housing agencies is the use of a formal housing needs analysis facilitating the allocation of tax credit resources to regions within their state with the highest relative need for additional low-income housing opportunities. This formal targeting of resources to areas of greatest need may contribute to an implementation process that is less susceptible to exploitation by

developers seeking excessive profits, since the location of proposed housing is determined by need, rather than by developer preferences.

The North Dakota Housing Finance Agency began using a formal needs analysis to guide location of tax credit housing in 2004, the final year of the five-year period covered by this study. The introduction of a needs analysis into program implementation resulted from a strategic planning initiative which included both internal and external stakeholders of the North Dakota Housing Finance Agency. Under the North Dakota system, proposed developments receive additional points in the competitive scoring process if they will be located in areas formally identified as having the greatest need.

As presented earlier in this research, the greatest need for affordable rental housing in the U.S. is among those in the federal extremely low income category—e.g., those with incomes at or below 30 percent of area median (Nelson, et al., 2003; Nelson, 1994). However, Congress designed the Low Income Housing Tax Credit so that developers may receive funding to provide housing with rents tied to household incomes of up to 60 percent, regardless of the actual income level of the tenant living in that unit. Recognizing the disparity between federal program requirements and actual housing need, some states have set their housing policy priorities so that at least a portion of tax credit resources are used to serve the extremely low income group. Typically, these states create a project selection incentive in the competitive process for

proposed developments that will set the rents for a portion of their units at a level appropriate for extremely low income households.

North Dakota provides a substantial selection preference for developments including units with income restrictions at the extremely low income level. This provides a direct incentive for developer-agents to produce rental housing opportunities within the financial means of extremely low income households.

In addition, North Dakota offers a selection preference for tax credit developments that are to receive Rural Development funds administered by the U.S. Department of Agriculture. Federal Rural Development funds frequently include project-based rental assistance allowing income-qualified tenants to pay no more than 30 percent of gross monthly income for housing, including utilities. Thus, providing a selection preference for proposed developments with Rural Development funding is an indirect means of stimulating housing opportunities for extremely low income households, since the project-based rental assistance available under Rural Development will make tax credit units with 60 percent of area median income restrictions financially accessible to this group.

The reader will recall that nonprofit participation in the Low Income Housing Tax Credit has been a federal requirement since 1988. Since that time, each state has been required to allocate at least 10 percent of its housing tax credit resources to developments sponsored by nonprofit housing organizations. The reasoning behind

this requirement is that nonprofits agents may have goals more aligned with those of the public interest, because they are motivated by the desire to serve a particular segment of the population, rather than by profit.

Further, Bryce (2005) has claimed a special role for nonprofit entities in the policy process. He asserts that nonprofits are important representatives of the public, in that nonprofit organizations must have a public purpose in order to receive federal tax-exempt status. Thus, states that formally foster the input of nonprofit developers, housing advocates—themselves frequently part of nonprofit organizations—and citizens may structure their competitive arena in such a way that the ability of for-profit developers to capture windfall profits is diminished.

As presented earlier in this chapter, North Dakota continuously solicited public input into housing policy priorities and the competitive selection process on an informal basis throughout the year for the period 2000 through 2004. Further, draft Qualified Allocation Plans reflecting these priorities and the competitive selection process were available for public comment before each year's Plan was finalized. Public meetings were also held to solicit public comment on the Qualified Allocation Plan, and a copy of the draft and final Plans are made available on the North Dakota Housing Finance Agency website each year. This process appears to have been an effective contributor to the state's performance, since North Dakota was the state with the lowest level of unexplained variation in the tax credit implementation process. It may also be

that North Dakota's relatively small population and land area facilitates public input into policies and programs.

The formal assessment of developers' program compliance history in the project selection process may help public organization principals hold developers accountable for their actions. This accountability may reduce the agents' capacity to obtain excessive profits through the program.

North Dakota, however, does not use a formal system to assess developer compliance during the competitive application process. Indeed, the only accountability for past performance is in the form of ineligibility to participate if the developer has been barred from competition in any other federal program or in other programs administered by the state of North Dakota. Although this result seems counterintuitive in terms of high performance, it may be that the state has so effectively managed the program over the years that poor compliance among developers is not present. Also, striking instances of noncompliance in a small state are likely to be immediately evident; this may curb any leanings towards moral hazard in compliance on the part of developers. Therefore, it need not be addressed through a selection penalty.

Beginning with federal Low Income Housing Tax Credits allocated in 2000, market studies for each tax credit development were required before a project could be selected for funding (Guggenheim, 2003). Market studies are typically produced by professional analysts who rely on developer-commissioned studies to earn their living.

However, developer-commissioned studies may have more potential for bias than those commissioned by the state housing agency, since the agency has no vested interest in the outcome of a particular application for resources. Thus, a high-performing state may institute a process of directly commissioning market studies for tax credit developments.

North Dakota deals with the market study issue by making public a list of approved market analysts; developers must choose from this list or obtain approval for engaging the services of an analyst not already on the list. While this falls short of the state directly commissioning the studies, the market analyst's remaining on the approved list is likely affected by his or her performance in producing a professional, and to the greatest extent possible, unbiased study.

Another aspect of managerial control may be introduced by the inclusion of unit cost limitations in project selection criteria. As presented earlier in this work, tax credits are based on a percentage of total development costs; this creates a financial incentive for developer-agents to design developments that will result in the highest total development costs. The state may address the incentive to inflate total development costs by setting a limit on the allowable development costs per housing unit.[19]

North Dakota's competitive process includes a feature known as efficient use of tax credits. Part of this calculation relies on unit costs expressed on a square footage

[19] Per-unit housing cost limitations allow for equitable comparison of developments with different numbers of units. For instance, some proposed developments may have 50 units, while others have 300; operationalizing the cost limitation on a per-unit basis facilitates comparison between these developments.

basis. Thus, while unit cost limitations are not explicitly present, they do factor into the evaluation of applications for resources and may contribute to the North Dakota State Housing Finance Agency's effectiveness.

As previously presented, the competition for federal Low Income Housing Tax Credit dollars is dominated by for-profit firms on a national basis. Profit-motivated firms have a strong incentive to exploit programmatic information asymmetries inherent in the competitive process and gain windfall profits. Strong nonprofit participation in the competitive arena may diminish the ability of for-profit developer-agents to obtain windfall profits by offering the state housing agency-principal nonprofit agents with goals more consistent with the public interest as expressed in state housing policy priorities than will for-profit developers. Many nonprofit organizations do not have the financial wherewithal to successfully compete with for-profit development organizations, however. Some states (such as Georgia) seek to ameliorate this lack of nonprofit capacity by offering formal programs intended to build such capacity.

Table 9 provides a summary of nonprofit participation in the Low Income Housing Tax Credit for the period 2000 through 2004.

Table 9
North Dakota Nonprofit Participation
As Percentage of State's Annual Tax Credit Allocation

2000	2001	2002	2003	2004
38	46	48	37	5

Source: National Council of State Housing Agencies (2001, 2002, 2003, 2004, 2005)

In all years within this study except 2004, North Dakota performed well above the federal requirement that ten percent of Low Income Housing Tax Credit resources be allocated to developments sponsored by nonprofit agents. The large decline in nonprofit participation between 2003 and 2004 may be associated with the decline in overall program participation; the reader will recall that fewer resources were requested in 2004 than were actually available. The results for 2004 may be an outlier, particularly given the strong trend of nonprofit participation for the first four years in the study period.

North Dakota does not offer a formal program for building nonprofit housing organization capacity. Rather, the state views partnerships between inexperienced nonprofit organizations and for-profit developers as a means for nonprofits to eventually gain sufficient experience to be successful in the competitive arena on their own. While the assumption that collaboration always produces results superior than those obtained without collaboration is not necessarily well founded in empirical evidence (McGuire, 2006), North Dakota's experience provides at least limited evidence that such collaboration may work.

As presented in this dissertation's analytical framework, an agent may not behave in accordance with the principal's expectations once selected. This condition is referred to as moral hazard (Waterman & Meier, 1998; Sappington, 1991; Pratt & Zeckhauser, 1985; Moe, 1984). Thus, an effective state housing agency in the Low Income Housing Tax Credit program must have a management control system that not only includes an appropriately structured competitive arena for resources, but also monitoring strategies intended to reduce the risk of moral hazard among developers.

Some states use outsourcing to fulfill federal compliance monitoring activities in the Low Income Housing Tax Credit program. Other states rely on in-house compliance monitoring staff for this purpose.[20] Because reliance on outsourcing introduces another third-party agent or agents into the implementation process, it may reduce the ability of the state to introduce a desirable level of hierarchy into the implementation network. Third-party compliance monitoring agents will have their own goals, and these goals may be more consistent with the profit orientation of the majority of developers than with the public interest goals of the state. Therefore, high-performing states may prefer to rely on in-house expertise for the compliance monitoring function. This is true for the North Dakota State Housing Finance Agency.

Milward and Provan (1998) and Miller (1992) have written that the most effective principal is one who is inflexible in his or her requirements of the agent. This leads to

[20] For instance, Florida contracts out its compliance monitoring activities, while Georgia relies on in-house compliance monitors.

the question of whether the most effective states are relatively inflexible in their compliance monitoring activities. No conclusive information was gained about this issue, since the state housing agency officials interviewed confined themselves to responding that their agency followed federal requirements.

Finally, when an instance of noncompliance is found, the level of rigor with which the state housing agency follows up to ensure agent compliance is obtained may enhance the principal's effectiveness in working with the agent. Little information was available on the rigor of compliance monitoring follow-up activities, since state officials once again responded that all instances of noncompliance are treated in accordance with federal requirements.

The potential for legal action against state housing agencies or developers with regard to instances of noncompliance in the Low Income Housing Tax Credit program likely had an impact on the willingness of state agency officials in all of the case study states to talk about specifics of the compliance monitoring process. Legal action against state housing agencies and developers may include—but not be limited to—U.S. Department of Justice actions related to federal Fair Housing Choice requirements. Thus, discussions of flexibility or specific processes that may even slightly deviate from federal requirements are unlikely to occur.

South Dakota

South Dakota's estimated population for 2004 was 770,188, making it only slightly more populous than North Dakota. Unlike its northern neighbor, population grew by 8.5 percent between 1990 and 2000.[21] It population density in 2000 was 10.2 persons per square mile, slightly higher than that of North Dakota.

As with North Dakota, small population and low density have implications for housing program administration. What distinguishes South Dakota from North Dakota is its much higher growth rate. The 8.5 percent population growth rate in South Dakota may translate into an upward pressure on housing markets, particularly in urban areas such as Rapid City and Pierre. This pressure may increase the need for additional housing opportunities for low-income households, including those who work for the many bank credit card companies that have located payment processing and customer service operations in the state over the last 20 years.

State Housing Agency Overview

The South Dakota Housing Development Authority is the officially designated state housing credit agency for South Dakota. Agency features are presented in Table 10.

[21] U.S. population grew 13.2 percent for the same period (U. S. Census Bureau, 2007).

Table 10
South Dakota Housing Development Authority Overview

FEATURE	DESCRIPTION
Year Created	1973
Public Authority	Yes
Gubernatorial Supervision	Yes
Number of Board Members	7
Number of Board Members Appointed by Governor	7
State Legislature Approval of Board Members	Yes
Governor Appoints Executive Director	Yes
Board Appoints Executive Director	No
Number of Full-Time Staff	58
Annual Operating Budget (2004)	$5,941,050

Source: National Council of State Housing Agencies (2001, 2002, 2003, 2004, 2005)

The South Dakota Housing Development Authority was created in 1973; it was established with the public authority organizational form. The governor has direct supervision of the authority and also appoints the 7 members of its Board of Commissioners. Legislative approval is necessary to confirm gubernatorial appointments to the board. Further, the governor appoints the authority's executive director.

Membership in the Board of Commissioners is somewhat less weighted toward the real estate industry than governing bodies found in the other three case study states. The board chair is executive director of a community service-oriented nonprofit foundation, while the vice chair is a manager for a clinic serving low-income persons. The treasurer is chief executive officer of a state bank. Other commissioners include an agricultural specialist, an attorney, a businessperson and a retired mortgage lender.

There are 58 full-time staff members in the South Dakota Housing Development Authority; the annual operating budget for 2004 was $5,941,050. As with North Dakota, the state housing agency operates a number of programs directed at homeownership and other community activities; therefore, only a portion of the full-time staff and operating budget are dedicated to Low Income Housing Tax Credit implementation.

Table 11 provides information on the tax credit resources available in South Dakota for the period 2000 through 2004, as well as requests for housing tax credits by developers. These requests are presented in dollars and as a percentage of available resources in each of the study years.

Table 11
South Dakota
Annual Tax Credit Availability and Requests, 2000-2004

YEAR	TOTAL TAX CREDITS AVAILABLE (IN DOLLARS)	TAX CREDITS REQUESTED (IN DOLLARS)	TAX CREDITS REQUESTED AS % OF TOTAL AVAILABLE
2000	$1,103,776	$1,744,391	158.04%
2001	2,004,941	2,384,942	118.95%
2002	2,002,860	2,477,114	123.68%
2003	2,065,836	2,327,116	112.65%
2004	2,580,925	2,175,665	84.30%
TOTAL	$9,758,338	$11,109,228	119.52%

Source: National Council of State Housing Agencies (2001, 2002, 2003, 2004, 2005)

The dollar amount of Low Income Housing Tax Credit resources available in South Dakota for the period 2000 through 2004 ranged from a low of just over $1.1 million in 2000 to nearly $2.6 million in 2004. Developer requests for tax credits ranged

from a low of $1,744,391 (2000) to a high of $2,477,114 (2002). Total available program funding for 2000 through 2004 was $9,758,338, while developer requests during that period totaled $11,109,288. Once awarded to developers and taken over the statutory ten-year period, the $9,758,388 in available program funding translates into $97,583,380 in public subsidy, in nominal dollars.

Expressed as a percentage of total available program resources, developer requests were highest in 2000, with just over 158 percent of available resources being requested. Requests as a percentage of available resources fell steadily over the five-year period, resulting in developer requests for only 84.30 percent of available tax credit resources in 2004. As was North Dakota, South Dakota was affected by the Congressional increase in the minimum level of tax credit funding that became available in 2001 (minimum of $2 million, regardless of population). Taken alone, this increase in resources may not have been sufficient to drive the decreasing level of requests as a proportion of available resources. The impact of organizational structure and managerial practices employed by the South Dakota Housing Development Authority must also be explored with the purpose of finding causal relationships between the low level of unexplained variation in their program implementation and the associated high performance as a state.

Organization and Hierarchy

As with the exploratory case study on the North Dakota Housing Agency, the South Dakota Housing Development Authority was analyzed with regard to the presence of external hierarchy in the form of gubernatorial supervision, as well as the agency's internal hierarchy and its likely impact on discretionary decision making by public managers. Further, external stakeholder access to the policy process was examined, as well as level of staff expertise within the state housing agency.

As previously presented, South Dakota's governor has responsibility for direct supervision of the South Dakota Housing Development Authority, as well as for selection of the authority's executive director. This implies a relatively strong role for the principal's principal—in this case, the elected official with oversight of the state housing agency at the center of policy implementation activities. The reader will recall that the regression results obtained in Chapter 4 produced a somewhat counterintuitive result, in that gubernatorial supervision, on average, produced greater levels of excess requests for resources by developers, rather than lower. This result may be explained by relatively political influence wielded by developers in many states.

While the South Dakota Housing Development Authority is under gubernatorial supervision, this did not result in higher requests for resources by developers. Interviews with state agency officials and developers revealed one reason why this may be true: the governor does not get involved in setting housing policy priorities or

selection criteria for the Qualified Allocation Plan, the document that structures the competitive arena for tax credit resources in each state. The governor has been described as simply signing the document in accordance with federal requirements. Another reason why gubernatorial oversight appears to motivate high performance on the part of the state housing agency is that as a small state, its actions are likely to be more susceptible to various forms of evaluation, including informal perceptions by elected officials, citizens and public management peers within other state agencies regarding the quality of its performance.

A review of the internal level of hierarchy present in the South Dakota Housing Authority revealed internal management processes with a greater level of hierarchy than found in North Dakota, the other high-performing case study state. Deviations from written policies and procedures in Low Income Housing Tax Credit implementation must be approved by the agency's Board of Commissioners. Those interviewed indicated there was little, if any, discretion for such deviations left in the hands of program managers or the executive director. Further, state agency officials interviewed highlighted their perception that there is an especially close working relationship between the housing agency and its board. This close working relationship may facilitate the effective functioning of hierarchy both within the state housing agency and in the implementation network that includes developers.

South Dakota seeks public input into each year's Qualified Allocation Plan through press releases requesting comment on housing policy priorities and project selection criteria. Public meetings are also held before finalizing the Qualified Allocation Plan each year. Meeting attendees tend to be members of the development community, but they are also sometimes members of the public with interests associated with housing, such as historic preservation. Further, one South Dakota official noted that public and nonprofit managers involved with housing issues throughout the state tend to stay in constant, informal communication throughout the year regarding low-income housing needs and trends. This continuous feedback provides the state housing agency with information that might otherwise be unavailable.

Another factor associated with an understanding of how hierarchy affects input by nonprofits, housing advocates and citizens is the Board of Commissioners' membership. Unlike the vast majority of state housing agency boards, South Dakota's board is led by two individuals whose professional orientation is specifically that of serving low-income persons. Further, the remaining board members are not dominated by members of the real estate industry. The board's composition has implications for how the board gathers and processes information about low-income housing needs within the state on both a formal and informal basis. At a minimum, the South Dakota Housing Authority's board provides indirect representation for low-income households

through its leadership by those who serve these households in their primary professional capacity. Further, advocates and citizens may feel more comfortable approaching this board with feedback or comments than they would a board dominated by members of the real estate industry.

The tax credit program in South Dakota is managed by an individual who has been employed in that capacity since 1998. She was recently promoted, but retains responsibility for program management. Thus, the public manager primarily responsible for day-to-day programmatic operations is a relatively well-seasoned individual. This experience may be a contributing factor in the state's ability to effectively deal with information asymmetries in their working relationships with developers.

Managerial Control and Hierarchy

As with North Dakota, the other high-performing state included in these case studies, South Dakota was examined for the level of hierarchy it appears to be able to introduce into the Low Income Housing Tax Credit implementation network through managerial controls. The first issue examined was that of the use of formal housing needs assessments for determining where Low Income Housing Tax Credit developments should be located within the state.

No formal housing needs assessment is used to structure the competitive arena for housing tax credit resources in South Dakota. Instead, a South Dakota official

indicated that not only state housing agency staff, but also board members, are very familiar with the areas of housing need within the state. Among other methods, state agency staff and board members regularly work with local public housing authorities throughout the state. These working relationships provide insights into regional housing needs. Although South Dakota's needs assessment process is informal, it appears to be sufficient to allow the state to achieve a high level of performance in its implementation of the Low Income Housing Tax Credit. The relatively small size of the state may contribute to the state's capacity to make effective use of informal needs assessment techniques.

While the South Dakota Housing Development Authority does not have competitive project selection criteria favoring developments that will reserve a portion of their units for households in the federal extremely low income category, it does provide an incentive for projects that include units for those at 40 percent of area median. This is somewhat higher than the up-to-30 percent of area median income that places a households in the extremely low income group, but it is still considerably lower than the 60 percent of area median making up the basic federal requirement for tax credit units.[22]

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[22] The 40 percent of area median income selection preference translates into a preference for housing units with income restrictions falling into the federal very low income category, which is between 30 and 50 percent of area median—an income group that is typically more in need of publicly assisted housing than are those at the 60 percent level.

Further, as in North Dakota, South Dakota offers project selection incentives for developments that will also include federal Rural Development funding. As presented earlier, this funding frequently allows extremely low income households to bridge the gap between their actual income and the 60 percent of area median income rents associated with most tax credit units. Thus, this aspect of the state's competitive selection criteria indirectly stimulates production of housing opportunities for extremely low income households.

Multiple, formal venues for policy and program input by nonprofit developers, housing advocates and citizens may increase the probability that a state's competitive arena for tax credit resources will be structured to best ensure that projects selected for funding meet state housing policy priorities, rather than developers' goals for obtaining excessive profits. However, South Dakota uses the traditional methods of press releases and required public meetings for comment on each year's Qualified Allocation Plan, rather than a more complex feedback system. The informal means of feedback and the close working relationships the Board of Commissioners and state housing agency staff appear to have throughout the state seems to be adequate to facilitate high performance in administering the Low Income Housing Tax Credit program. Again, this may be associated with the relative size of state's population; such a result might not be obtained with the same methods in a larger state.

South Dakota does not formally assess developers' compliance history when making selections of projects to be funded in each competitive round. Instead, an applicant is simply considered ineligible if there are significant instances of noncompliance with a developer's properties previously funded under the tax credit program. As with North Dakota, it may be that noncompliance is not an issue that has arisen with any degree of seriousness within the state; therefore, no formal scoring criteria are necessary in the competitive process.

In terms of the managerial strategy of directly commissioning federally required market analyses on proposed projects, South Dakota publishes a list of approved market analysts from which the developer must select but does not directly commission the studies. If a developer wishes to choose an analyst not on the list, they must obtain the permission of the South Dakota Housing Development Authority.

South Dakota addresses the issue of developers' motivation to increase total development costs by imposing explicit unit cost limitations that depend on the number of bedrooms in each unit. One developer interviewed described these limitations as their biggest struggle with the program, in that there is a tension between keeping costs low in the short run and using higher quality materials that may reduce costs in the long run.

South Dakota does not engage in nonprofit housing organization capacity-building activities. Instead, South Dakota's housing agency regularly communicates

with nonprofit housing organizations when the U.S. Department of Housing and Urban Development is scheduled to offer training sessions or technical assistance for nonprofits. Nonprofit participation as a percentage of tax credit allocations is presented for the period 2000 through 2004 in Table 12.

Table 12
South Dakota Nonprofit Participation
As Percentage of State's Annual Tax Credit Allocation

2000	2001	2002	2003	2004
55	38	13	9	0

Source: National Council of State Housing Agencies (2001, 2002, 2003, 2004, 2005)

Nonprofit participation in the Low Income Housing Tax Credit program fell from a high of 55 percent of resources allocated in 2000 to no nonprofit allocations in 2004. This stark result may have been caused by a number of factors. One possibility is that for-profit agents became more willing to align their goals with the state's housing policy priorities over time; this willingness would have translated into the proposal of developments that would gain relatively high scores in the competitive selection process. Thus, nonprofit participation could have been crowded out by for-profit developers willing to undertake housing similar to that previously provided only by nonprofits. Alternatively, for-profit developers may have successfully influenced state housing policy priorities and competitive selection criteria so that development opportunities most appealing to for-profit developers had a high probability of being

funded. Still another alternative is that nonprofit housing organizations failed to compete in the same numbers as in prior years, leading to fewer resource allocations to nonprofit agents.

Although nonprofit participation fell sharply between 2000 and 2004, excess requests for tax credit resources also fell sharply for the same period. Other explanations for the decline in nonprofit participation and excess requests for tax credit resources may also include a perception that housing markets are saturated with low-income rental units (or if not saturated, then sufficient low-income rental units exist); or policy preferences began to lean heavily toward serving low-income households with down payment assistance and other programs designed to boost homeownership. Such a transition in policy preferences would be consistent with the federal emphasis on homeownership programs generated by the Bush Administration's American Dream program.

South Dakota provides program compliance monitoring through in-house staff. Both the public officials and developers interviewed indicated a high level of satisfaction with in-house compliance staff. This satisfaction is based at least in part on lack of responsiveness on the part of outsourced compliance monitors that had been part of program implementation until approximately five years ago. Outsourced compliance monitoring was used following the election of a governor who favored contracting-out arrangements for public services. The organization providing the

outsourced services was found to be slow and unresponsive by both state housing agency staff and developers seeking to appropriately address compliance issues. This result provides some support for the ability of an in-house compliance monitoring function to make a contribution to a high level of performance on the part of the state.

As with efforts to obtain information on the principal's inflexibility in compliance standards and the processes used to follow-up on instances of noncompliance among developers in North Dakota, little information was obtained in South Dakota other than an emphasis on following federal regulations.

Summary

The two high-performing states analyzed in this chapter's case studies varied in dimensions associated with external and internal hierarchy, although both agencies appear to have introduced an effective level of hierarchy into their working relationships with their network of agents. While one state is not directly under gubernatorial supervision, the governor is in a leadership role within the organization responsible for state housing agency oversight, the North Dakota Industrial Commission. Table 13 provides a summary of common features found in both high-performing states.

Further, neither state housing agency had a governing board dominated by the real estate industry, although the real estate industry had proportionally higher representation in North Dakota than in South Dakota. That fact that both states have

small populations may also contribute to high performance, in that the activities of the state housing agencies—as well as those of developers—may be relatively transparent to the public and therefore provide few opportunities for slack management on the part of the principal or exploitation of the system by agents.

Both states engaged in competitive selection practices designed to foster rental housing opportunities for those who fall below the federal maximum income restriction of 60 percent of area median found in the Low Income Housing Tax Credit program. Although North Dakota provided a stronger selection incentive for serving extremely low income households than South Dakota, South Dakota did have in place selection preferences for developments with units targeting households slightly above extremely low income levels. In addition, both states provided incentives for developers to combine the housing tax credit with federal Rural Development funds—a combination that typically allows housing opportunities within the financial means of extremely low income households.

Table 13
Common Features of High-Performing Principals

FEATURE	NORTH DAKOTA	SOUTH DAKOTA	COMMENTS
Hierarchy provides access to policy process	Citizen Advisory Board composition may facilitate access for stakeholders representing citizens	Board of Commissioners composition may facilitate access for stakeholders representing citizens	The policy input process in both states is enhanced by regular, informal input by those who serve low-income households. This input may be facilitated by the inclusion of board members whose primary professional orientation is serving low-income households
Staff expertise	Public manager responsible for Low Income Housing Tax Credit program has extensive experience, including experience with other publicly funded multifamily rental programs	Public manager responsible for tax credit program has nine years' experience with the Low Income Housing Tax Credit program	Both state housing agencies have public managers who have the requisite experience to work effectively with developers; their level of knowledge and experience is likely to reduce developers' ability to exploit information asymmetries in the principal-agent relationship

FEATURE	NORTH DAKOTA	SOUTH DAKOTA	COMMENTS
Selection preferences for extremely low income households	North Dakota provides a substantial preference for proposed developments with units income-restricted for extremely low income tenants. An indirect incentive is also supplied through a selection preference for proposed developments that will also receive federal Rural Development funds. The additional federal funds expand the number of units available within the financial means of extremely low income households.	South Dakota provides a selection preference for units with income restrictions slightly above extremely low income, but also provides indirect selection preference for proposed developments that will also receive federal Rural Development funds. The additional federal funds facilitate provision of units within the financial means of extremely low income households.	While North Dakota provides a very strong selection preference for extremely low income units, South Dakota's preference comes close by providing a preference for units with income restrictions set slightly above extremely low income (30% of area median or below) for households at 40% of area median income. Further, both states provide an indirect selection preference for serving extremely low income households by providing additional competitive scoring based on the inclusion of federal Rural Development funds in the tax credit development's funding package.
Formal venues for nonprofit, advocate and citizen input into policy implementation process	Formal venues include standard public announcements and public meetings.	Formal venues include standard public announcements and public meetings.	The apparent efficacy of each state's informal policy participation processes seems to augment the traditional means employed in each state.

FEATURE	NORTH DAKOTA	SOUTH DAKOTA	COMMENTS
State housing agency directly commissions market studies for proposed developments	State housing agency does not directly commission market studies, but requires developers to choose analysts from an approved list.	State housing agency does not directly commission market studies, but requires developers to choose analysts from an approved list.	Although neither state directly commissions market studies for proposed developments, the requirement that developers choose an analyst from the approved list appears to be an effective means for obtaining accurate information. Analysts' desire to remain on the approved list may allow the state housing agency to introduce a sense of hierarchy between itself and the analyst.
Unit cost limitations	North Dakota indirectly introduces unit cost limitations by including these costs in a scoring criterion known as efficient use of credits	South Dakota publishes unit cost limitations each year. These limitations are based on the number of bedrooms in each unit.	Both states have designed and implemented an effective means to control developer-agent behavior with regard to development costs.
Nonprofit organization capacity building	No formal capacity building for nonprofits, but partnerships between nonprofits and for-profit developers are encouraged as a learning experience for the nonprofit.	No formal capacity building is offered for nonprofits, but the state housing agency regularly communicates with nonprofit housing organizations regarding upcoming opportunities for training and technical assistance offered by the U.S. Department of Housing and Urban Development.	Informal means for facilitating nonprofit participation appear effective in these states.

FEATURE	NORTH DAKOTA	SOUTH DAKOTA	COMMENTS
In-house compliance monitoring	North Dakota has always relied on in-house compliance monitoring staff.	South Dakota formerly used an outsourcing arrangement for compliance monitoring, but changed this to in-house monitoring five years ago. Both state agency staff and developers are much more satisfied with the in-house staff than the outsourcing arrangement.	Both states rely on in-house compliance monitoring expertise. South Dakota's experience with moving from an outsourcing arrangement to in-house provision of services highlights the merits of in-house provision.

Both states incorporate the concept of housing unit cost limitations into their competitive selection process, although through different means. Neither state directly offers organizational capacity building activities for nonprofit housing developers, but both experienced strong, albeit declining, nonprofit participation during the 2000-2004 period.

Compliance monitoring is a sensitive topic for discussion by both state officials and developers. In one sense, little was gained from an effort to focus on the compliance issue other than assurance that each state followed federal regulations. However, positive descriptions of South Dakota's transition to in-house performance of the compliance monitoring function were obtained in independent interviews with state officials and developers. This provides some basis for concluding that in-house

compliance monitoring is preferable to outsourcing arrangements, all other things being equal.

Chapter 6 will provide two case studies states that performed more poorly than predicted in the Low Income Housing Tax Credit program. Differences and similarities between the low performers will be explored. Chapter 7 will contrast high and low performers and provide policy recommendations, as well as suggestions for future research.

CHAPTER 6

STATES PERFORMING MORE POORLY THAN PREDICTED

This chapter provides an analysis of two states that performed more poorly than predicted in the Low Income Housing Tax Credit implementation process. As presented in Chapter 4, states with the largest positive residuals in regression model results were interpreted as performing more poorly than predicted. In other words, their residuals fell above the regression model's predicted line of performance. This can be interpreted as evidence that these states performed more poorly than predicted in terms of effectiveness in reducing the capacity for developers to capture windfall profits through the program than are states with large negative residuals. Alabama was the state with the largest positive residual, followed by Illinois and Texas.

Illinois was not chosen for case study analysis, because it is an outlier among the states. The reader will recall that Congress required each state to choose a single housing credit agency when Low Income Housing Tax Credit implementation began in 1987 (Solem, 1987). However, the City of Chicago received special permission to receive and administer its own allocation of housing tax credits; the rest of the state is served by the Illinois Housing Development Authority. As the only state with two housing credit agencies, the issues facing the Illinois Housing Development Authority are likely to be

somewhat different than those facing other state housing agencies. Therefore, Texas was chosen as the second state performing more poorly than predicted for case study.

As with the case studies of states performing better than predicted in Chapter 5, the case studies presented in this chapter are exploratory in nature. The issues addressed in this chapter are structured in the same manner as the material in Chapter 5.

Alabama

Alabama's estimated 2004 population was 4,517,442; it grew 10.1 percent between 1990 and 2000, as compared with the U.S. population growth rate of 13.2 percent for that period. Among the states, Alabama was ranked 25 for population growth between 1990 and 2000. With 89.8 persons per square mile, it is far more densely populated than any of the other case study states (U.S. Census Bureau, 2007).

Although Alabama is far more densely populated than North Dakota or South Dakota, it also has less densely populated rural areas, many of which are economically distressed. The lower-density rural areas may not generate enough demand for rental housing to make development with the Low Income Housing Tax Credit feasible, although these areas may have a high level of need for housing opportunities for low-income households relative to the rest of the state.

State Housing Agency Overview

The Alabama Housing Finance Authority is the officially designated state housing credit agency for Alabama. Features of this agency are presented in Table 14.

Table 14
Alabama Housing Finance Authority Overview

FEATURE	DESCRIPTION
Year Created	1980
Public Authority	Yes
Gubernatorial Supervision	No
Number of Board Members	15
Number of Board Members Appointed by Governor	8
State Legislature Approval of Board Members	No
Governor Appoints Executive Director	No
Board Appoints Executive Director	Yes
Number of Full-Time Staff	34
Annual Operating Budget (2004)	$3,174,000

Source: National Council of State Housing Agencies (2001, 2002, 2003, 2004, 2005)

The Alabama Housing Finance Authority was created in 1980 and relies on the public authority organizational form. The governor does not directly supervise the authority. Rather, it is overseen by a Board of Directors made up of political appointees and *ex officio* members. The governor has the power to appoint one member from each of the state's Congressional districts, for a total of eight appointees. By law, the governor's appointments must include two home builders, two real estate brokers, a lender, a mayor and a county commissioner. This lieutenant governor and speaker of the House may each appoint two board members; there are no restrictions on the

professional orientation of these members. Finally, the state's finance director, treasurer and superintendent of banks serve as *ex officio* board members.

The executive director is appointed by the Board of Directors. While the governor has no direct role in this appointment, he or she may exercise influence in the choice through political appointees serving on the board. With 34 full-time staff members and an annual operating budget of $3,174,000 in 2004, Alabama has the smallest staff and operating budget among the four case study states. Its status among the four case study states as having the smallest staff and operating budget—despite its being the second largest in population and population growth—may be a contributing factor to the state's low-ranked performance. It also may be a reflection of the relative importance of housing policy and programs within the state's sociopolitical culture.

Table 15 provides information on tax credit resources available in Alabama for the years 2000 through 2004, as well as requests for housing tax credits by developers. These requests are presented in dollars and as a percentage of available resources in each year.

Table 15
Alabama
Annual Tax Credit Availability and Requests, 2000-2004

YEAR	TOTAL TAX CREDITS AVAILABLE (IN DOLLARS)	TAX CREDITS REQUESTED (IN DOLLARS)	TAX CREDITS REQUESTED AS % OF TOTAL AVAILABLE
2000	$5,658,332	$21,264,561	375.81%
2001	6,772,921	17,952,726	265.07%
2002	8,046,930	19,926,357	247.63%
2003	8,631,027	37,520,850	434.72%
2004	9,689,261	35,397,634	365.33%
TOTAL	$38,798,471	$132,062,128	340.38%

Source: National Council of State Housing Agencies (2001, 2002, 2003, 2004, 2005)

Low Income Housing Tax Credits available in the state of Alabama ranged from $5,658,332 in 2000 to $9,689,261 in 2004. The total available for the five-year period was $38,798,471. Developer requests for tax credits ranged from a low of $17,952,726 in 2001 to a high of $37,520,850 in 2003. The nominal value of Alabama's available tax credits for the five-year period was $387,984,710, given that the tax credits can be taken each year for ten years.

Requests for housing tax credits during the period examined were likely impacted by judicial decision making regarding housing for persons with mental illness and developmental disabilities. The state's Supreme Court issued a decision in 2000 requiring that all of the state's tax credit allocations for the foreseeable future be dedicated to providing housing for persons with mental illness or development disabilities. The decision was to take affect for 2001 and beyond. Subsequent to the

decision, a number of Alabama-based developers began seeking opportunities to participate in the tax credit program in other states. Requests for tax credits as a percentage of available resources dropped from 375.81 percent in 2000 (prior to announcement of the Alabama Supreme Court decision) to a low of 247.63 percent in 2002. For competitive rounds taking place in 2003 and beyond, some selection preferences remain for housing for persons with mental illness or developmental disabilities, but they no are no longer overarching and do not appear to drive the competitive process. In 2003, requests rose to a high for the five-year period of 434.72 percent, possibly due in part to a condition of pent-up demand by developers who were not interested in providing housing for mentally ill persons or those with developmental disabilities. Requests for resources remain high at 365.33 percent in 2004, although this was a decline from the peak in 2003. Even at its lowest level of 247.63 percent in 2002, requests for tax credits as a percentage of available resources were substantially higher than those in either North Dakota or South Dakota for the same period.

Organization and Hierarchy

As with the other case study states, the Alabama Housing Finance Authority was analyzed with regard to external and internal hierarchy and its potential impact on public managers' discretionary decision making. Further, external stakeholder access to

the policy process was examined, as well as the level of staff expertise within the state housing agency.

As previously noted, Alabama's governor does not have responsibility for direct supervision of the state housing agency. Instead, the governor has appointment power for eight of the 15 members on the Board of Directors; the board provides the agency's oversight and is, in essence, the principal's principal in Low Income Housing Tax Credit implementation in Alabama.

Interviews with state agency managers and developers were used to gain insight into the actual role played by the governor in the tax credit implementation process. While developers saw the governor's participation as being limited solely to providing the federally required signature on the annual Qualified Allocation Plan, one state agency official mentioned that the governor had been instrumental in having selection preferences for economically distressed counties with a high level of minority population (known in Alabama as the Black Belt) introduced into the competitive selection criteria in a past year. This official also indicated that the governor had been involved with working out the issue of incentives for providing housing for persons with mental illness or developmental disabilities when the state's Supreme Court made its decision regarding housing for these individuals.

While the state housing finance agency does not have its governor in a position of external hierarchy, it does have a board with a substantial number of members

(eight) appointed by the governor. Further, five of these appointees must include members of the real estate industry. It may be that strong representation by the real estate industry made its way into the board's structure as a means of providing a particular kind of expertise on the board; the fact that the Low Income Housing Tax Credit program is financially and operationally complex to the point of being arcane is an argument in favor of having such expertise within the state agency's governing body. In contrast, the presence of five gubernatorially appointed representatives of the real estate industry could be interpreted as a tacit grant of control to the real estate industry. Further, the board appoints the executive director. Therefore, it is likely that representatives of the real estate industry have substantial influence in this selection.

There is a strong sense of hierarchy between the Board of Directors and public managers within the Alabama Housing Finance Authority. Any waivers of written policies and procedures typically require board approval, although two long-serving public managers—the housing credit coordinator and the lead underwriter—also exercise discretion on a day-to-day basis for many issues that arise in the administrative and compliance processes. Thus, in the state of Alabama the principal's principal is a board consisting primarily of political appointees, many of whom are representatives of the real estate industry. This may contribute to Alabama's relatively low ranking and an associated perception that developers are able to exploit the Low Income Housing Tax Credit program to obtain windfall profits in that state.

Where discretion is granted to public managers within the organization, it is granted to two very experienced individuals. Indeed, the housing credit coordinator has been with the agency for at least 15 years, making her one of the most experienced tax credit managers in the states. Further, the lead underwriter was formerly the compliance manager.

Developers indicated that their dealings with the state housing agency were almost entirely with these two individuals, and both nonprofit and for-profit developers indicated a high degree of respect for the expertise possessed by these functionaries. Therefore, by virtue of both length of tenure and reputation, the level of staff expertise appears to be well-suited to effective management of the tax credit implementation process, particularly with respect to averting problems arising from expertise-based information asymmetries between the state and developers. The potential contributions of this public management expertise to effective management of the competitive arena may, however, be constrained by the agency's oversight by politically appointed members of the real estate industry.

Access to the policy process appears to be limited, although all required public forms of input are sought. Developers reported that public hearings on the Qualified Allocation Plan are very sparsely attended, and there is little, if any, participation in forming state housing policy priorities or competitive selection criteria by nonprofits, advocates or citizens.

Overall, there appears to be a substantial degree of external hierarchy imposed on the Alabama Housing Finance Authority; however, this hierarchy does not appear to have the expected benefit of facilitating high performance. Instead, the oversight of the state housing agency by a politically appointed board with strong representation by real estate professionals may place the agency in the position of being captured by real estate interests.

Managerial Control and Hierarchy

As with the other case study states, Alabama's state housing agency was examined in terms of the managerial controls it employs for the introduction of hierarchy into the Low Income Housing Tax Credit implementation network and the likely effect of these controls. The first issue examined was the use of a formal housing needs assessment for the determination of where Low Income Housing Tax Credit developments should be located within the state.

An analysis of Alabama's 2000 Qualified Allocation Plan indicated that the state's competitive arena was at least partially structured based on formal analysis of housing need. The plan included a list of counties with the highest level of housing need, based on state agency analysis of Census data; however, the method for making this analysis was not presented. In addition, geographically based need was also determined based on whether there had been an allocation of housing tax credits within a particular county during the last three years. In 2001 and 2002, selection preferences

were awarded to proposed developments in certain counties, but only if those units were intended to serve persons with mental illness or developmental disabilities. The analysis of Census or other demographic data was deleted from the plan in 2001 and had not reappeared through the end of the study period in 2004. In 2003, the selection feature related to location of an allocation in the previous three years was reinstituted and was retained in 2004. Under this feature, an allocation to a county within the last three years reduces the application score.

Alabama does not offer a selection preference for tax credit housing units with rents based on extremely low income household resources. However, it does have selection preferences for two different types of rental assistance. Under one selection preference, applicants receive additional points for proposing developments where the developer will undertake an obligation to provide developer-funded rental assistance in a prescribed dollar amount for a certain number of units for a specified number of years. This developer-funded rental assistance is to be provided in amounts of up to $30 per month; the relatively small amount of assistance may be helpful to some households, but it is unlikely to be adequate to make a Low Income Housing Tax Credit unit affordable to those with incomes in the extremely low income category.

Alabama also offers a selection preference if developers are able to secure rental assistance for some or all of the proposed units from the U.S. Department of Agriculture's Rural Development program. Under this program, the property owner

receives a financial subsidy that covers the difference between the unit's actual tax credit rent and the amount tenants can pay, based on income. This selection preference provides an indirect stimulus for provision of housing meeting the financial needs of extremely low income households and is similar to the indirect Rural Development stimulus found in high-performing North and South Dakota.

Formal venues for seeking input from nonprofit organizations, advocates and citizens at large are confined to traditional public hearings announced in the state's major newspapers. Developers interviewed reported there is little, if any, participation by nonprofits, housing advocates or citizens at these meetings. The possibility exists that these groups provide input into the policy implementation process on an informal basis from time to time, but there is no outward evidence that this occurs. This apparent lack of input into state housing policy priorities and competitive selection criteria by nonprofits and others representing low-income households may be a cause for concern, particularly given the composition of the Board of Directors. The lack of such input on even an indirect basis through board membership may have a deleterious effect on the state's ability to structure the competitive process in ways that will reduce developer-agents' capacity to gain windfall profits through program participation.

The Alabama Housing Finance Authority uses a formal selection criterion that reduces the number of competitive points awarded to an application if there are instances of noncompliance in a developer's properties that received a tax credit

allocation in previous rounds of competition. This provision was not a feature of the competitive arena in either of the high-performing case study states. Therefore, there may be some reason to conjecture that the scoring criterion has been introduced to address compliance problems based on the existence of a distinct need to take such measures. Alternatively, this criterion may simply be an appropriate management control tool designed to foster compliance among tax credit developer-agents.

Market studies for proposed tax credit properties have been a federal requirement since late 2000 (Guggenheim, 2003). In Alabama, a list of preferred market analysts is made publicly available. In contrast to the three other case study states—all of which have a list of approved market analysts from which the developer must choose—developers in Alabama may choose from the list, but are not obligated to do so. However, any market study submitted with an application for tax credit resources must meet the standards of the Alabama Housing Finance Authority. Thus, there may functionally be little difference between the Alabama requirement and those of the other case study states.

While the two high-performing case study states include selection criteria related to the limitation of unit development costs, Alabama has no such formal requirement. However, developers interviewed indicated they are sure that the state housing agency's management team has a figure in mind when evaluating applications for funding. A for-profit developer described a process whereby applicants stay in touch on

a regular basis throughout the application preparation process, checking with one another about how their unit costs are shaping up, among other things. Thus, the developers felt there was a unit cost limitation aspect to the competitive process; it simply is not a part of formal selection criteria.

As previously noted, Congress passed a federal requirement that states allocate at least 10 percent of their tax credit resources to nonprofit organizations in 1988. Many interpret this requirement to mean that there is an assumption that nonprofit housing organizations have goals more congruent with the state than do for-profit developers. In many states, there is not a significant presence of nonprofit organizations with the financial or staff capacity to undertake the complex and resource-intensive process of applying for funds and developing low-income rental properties with the housing tax credit program. Thus, some states offer special capacity-building assistance to nonprofits.

Alabama does not provide direct capacity-building assistance, but does provide some funding from federal HOME funds for the external provision of such activities. The use of federal HOME funds in this manner may be an artifact associated with the HOME program requirement that grantees (including all states and certain local government entitlement jurisdictions) spend 15 percent of their HOME funds on nonprofit community development organizations. Table 16 provides information on the

level of nonprofit participation in Alabama expressed as a percentage of tax credits allocated each year during the 2000 through 2004 period.

Table 16
Alabama Nonprofit Participation
As Percentage of State's Annual Tax Credit Allocation

2000	2001	2002	2003	2004
33	35	30	22	16

Source: National Council of State Housing Agencies (2001, 2002, 2003, 2004, 2005)

Alabama's level of nonprofit activity may have increased for the period 2000 through 2002, owing to the state supreme court's decision requiring that a substantial portion of federal tax credit resources be used to house persons with mental illness or developmental disabilities. While a selection preference continued to exist from 2003 onward, it did not have the same form or impact as it did for the years 2000 through 2002.

As with the two high-performing case study states, compliance monitoring activities are provided by in-house staff. As with all of the case study states, there was no information made available by interviewees or in documentation that reflected any information outside of that indicating the agency performs the compliance function in accordance with federal requirements. As with the high-performing states, a reluctance to provide detailed perspectives on compliance monitoring processes is likely motivated by the severity of federal penalties associated with any real or perceived

deviation from federal Fair Housing Choice and other requirements on the part of either state or developers.

Texas

Texas's estimated 2004 population was 22,517,901. It grew by 22.8 percent between 1990 and 2000, making it the eighth fastest-growing state in the U.S. in that period. Texas's population density is moderate at 30.1 persons per square mile; this overall density figure masks the fact that vast areas of the state are much less densely populated, while significant urban areas exist within the state with much higher density levels.

Thus, Texas faces the dual challenge of providing low-income housing in a rapidly growing state, while also allocating resources to less densely populated and slower-growth rural areas. These two factors combine to make the equitable allocation of resources across the state an especially difficult process.

State Housing Agency Overview

The Texas Department of Housing and Community Affairs is the officially designated state housing credit agency for the state of Texas. The agency's features are presented in Table 17.

Table 17
Texas Department of Housing and Community Affairs Overview

FEATURE	DESCRIPTION
Year Created	1981
Public Authority	No
Gubernatorial Supervision	Yes
Number of Board Members	7
Number of Board Members Appointed by Governor	7
State Legislature Approval of Board Members	Yes
Governor Appoints Executive Director	No
Board Appoints Executive Director	Yes
Number of Full-Time Staff	274
Annual Operating Budget (2004)	$20,757,481

Source: National Council of State Housing Agencies (2001, 2002, 2003, 2004, 2005)

The Texas Department of Housing and Community Affairs was created in 1981 as a traditional government agency overseen by the governor. While the state housing agency is overseen by the governor, it is important to note that Texas is a weak executive state. Budgetary power actually resides with the Texas Legislature, led by the state's lieutenant governor, an individual elected separately from the governor. Thus, gubernatorial supervision of the state housing agency in Texas is something of a special case among the states.

A seven-member Governing Board appointed by the governor also provides oversight of the Texas Department of Housing and Community Affairs. The gubernatorially appointed board members must be approved by the Texas Legislature; this feature is, perhaps, not unexpected in a weak executive state. The Governing Board appoints the executive director; because the board is made up of political appointees

whose appointments are reliant on both the governor and the legislature, substantial political influence may be a part of the executive director appointment process in Texas.

The state housing agency is large, with 274 full-time staff members and a 2004 operating budget of nearly $21 million. The agency fulfills a number of roles in addition to administration of the Low Income Housing Tax Credit, however; therefore, only a portion of these staff and financial resources are devoted to program implementation. On the other hand, the size of the agency is an indicator of the importance of issues of housing and community development in the state's sociopolitical culture.

Table 18 provides information on the tax credit resources available in Texas from 2000 through 2004, as well as requests for housing tax credits by developers. These requests are presented in dollars and as a percentage of available resources for each year.

Table 18
Texas
Annual Tax Credit Availability and Requests, 2000-2004

YEAR	TOTAL TAX CREDITS AVAILABLE (IN DOLLARS)	TAX CREDITS REQUESTED (IN DOLLARS)	TAX CREDITS REQUESTED AS % OF TOTAL AVAILABLE
2000	$25,667,708	$115,896,296	451.53%
2001	31,718,824	91,330,307	287.94%
2002	38,297,245	89,000,000	232.39%
2003	39,012,052	87,341,715	223.88%
2004	41,571,704	97,309,776	234.08%
TOTAL	$176,267,533	$480,878,094	285.96%

Source: National Council of State Housing Agencies (2001, 2002, 2003, 2004, 2005)

Low Income Housing Tax Credits available in Texas for the period 2000 through 2004 ranged from $25,667,708 to $41,571,704. The total available for the five-year period was $176,267,533. Because tax credits may be used annually for a period of ten years once awarded, this translates into nearly $18 billion in public funding made available in Texas through the federal tax credit program between 2000 and 2004.

Tax credits requested by developers were highest in 2000, with more than 451 percent of available resources requested in the application process. Although the figure declined sharply to slightly less than 288 percent in 2001, the figure remained relatively high throughout the five-year period.

Organization and Hierarchy

The Texas Department of Housing and Community Affairs was analyzed with regard to the presence of external hierarchy—including gubernatorial supervision, the Governing Board, and the Texas Legislature—as well as the agency's internal hierarchy for its likely impact on public managers' decision making. Further, external stakeholder access to the policy process was examined, along with the level of state housing agency staff expertise.

The hierarchy imposed external to the Texas Department of Housing and Community Affairs is the most complex found among the case study states. Further, it is likely that it is more complex than many other states, owing to the nature of the

relationship between the weak executive and the legislature in Texas. The governor and legislature may have different policy priorities; in that state, it is the legislature that holds the power of the budget to make policies and programs happen. Therefore, the hierarchy external to the state agency may send conflicting signals from time to time.

Further, the Texas Legislature has formal power to structure the competitive arena for tax credit resources through the annual Qualified Allocation Plan. Based on state law, the legislature writes selection criteria for the program, as well as setting state housing policy priorities.

The gubernatorially appointed and legislatively confirmed Governing Board has significant representation from the real estate industry. Information was available on the professional orientation of six of the seven board members. Four members have connections with the real estate industry; a real estate broker, two developers (one of whom is also a small-town mayor) and an engineer specializing in construction management serve on the board. Other members include an information technology specialist and a retired military officer with substantial involvement in community-oriented nonprofit work.

The Governing Board appoints the executive director of the state housing agency in Texas. Thus, the appointment process may especially politicized, as the board itself is made up of gubernatorial appointees who must also be confirmed by the state legislature. The complexity of the hierarchical relationships external to the state housing

agency may be a contributing factor in its low performance in the Low Income Housing Tax Credit implementation process.

Internally, the Texas Department of Housing and Community Affairs is especially hierarchical. Interviews with state agency officials and developers had the repeated theme that not only policy priorities, but also the structure of the competitive arena through very specific project selection criteria, are prescribed by the state legislature. Discretion in program implementation in terms of resolving issues that may arise in the selection or administrative processes is not found at the program management or executive director levels. Rather, discretion is strongly constrained by processes and criteria put in place by the legislature. Deviations from written policies and procedures—if any—must be approved by the Governing Board.

The strong political involvement in Texas's Low Income Housing Tax Credit implementation likely has implications for the effectiveness with which the state manages working relationships with developers. The ability to exercise discretion is only available to the Governing Board, which is made up of political appointees and has a strong presence by representatives of the real estate industry. Further, the Governing Board is itself constrained in its exercise of discretion by the embodiment of specific features of program management and selection practices in Texas law.

In contrast to the other case study states, Texas does provide more formal venues for access to the policy implementation process than traditional public hearings and

public comment periods. The state conducts a number of roundtables each year to invite input into the Low Income Housing Tax Credit policy implementation process, along with more traditional public hearing and public comment methods for seeking stakeholder input. Roundtables are regularly attended by nonprofit organizations and housing advocates, as well as members of the for-profit development community. The relatively higher level of stakeholder input into the policy implementation process does not, however, appear to translate into increased programmatic performance. This may be in part due to the fact that the input provided at roundtables and other venues is filtered through the political bargaining processes of the state legislature, the body ultimately responsible for translating public input into policy priorities and specific competitive selection criteria in Texas.

One facet of internal hierarchy within the Texas Department of Housing and Communities Affairs that is unique among the case study states—and, indeed, may be seldom seen in any state—is that managers associated with the tax credit program may not have anything other than written communication with developer-agents during the application process. Lower-level staff members are permitted a limited degree of oral communication with developers. In any case, all communications by public managers or staff (written or oral) must be logged and described. The logged descriptions of these communications are placed with application materials when they are forwarded to the Governing Board for decisions.

Given the nature of external and internal hierarchy related to Low Income Housing Tax Credit program implementation in Texas, the issue of staff expertise may be somewhat less important as a factor explaining the state's performance than in states where staff exercise some level of discretion in program management. The influence of staff expertise is most likely felt through the quality of the information staff provide the Governing Board and legislature when called upon to do so. However, the Texas Legislature also relies heavily on the expertise found among staff in the House Research Organization, the Senate Research Center and the Texas Legislative Budget Board. Therefore, while public managers associated with tax credit program implementation in Texas are experienced, their ability to use their expertise to heighten the state's performance is likely to be limited.

Managerial Control and Hierarchy

Managerial control systems employed by the Texas Department of Housing and Community Affairs were examined for their capacity to foster a sense of hierarchy between the state the network of private-sector agents involved in Low Income Housing Tax Credit implementation.

Texas relies on formal analysis of housing need to structure selection preferences for tax credit applications. In 2000, the Qualified Allocation Plan reflected a consideration of city and county population trends, as well as rental housing affordability needs. However, there were no details presented in the document

regarding analytical methods used to arrive at the selection preferences. In addition, previous allocations of tax credits to a particular geographic area had the potential to reduce the application's score.

Beginning in 2001, Texas included a regional allocation formula intended to address low-income housing need on a regional basis throughout the state in its Qualified Allocation Plans. Interviews with state officials indicated this system was introduced because members of the Texas Legislature wanted to see greater geographic dispersion of resources throughout the state, particularly outside the largest cities. The regional allocation process continues to the present time, including a dollar limit on tax credits that may be awarded in any given region in a specific year.

Regional targeting is based on the deliberations of the state legislature. While the legislature may seek analytical input from the state housing agency and other legislative staff, including the Legislative Budget Board, regional targeting of resources remains a product of political deliberations within the legislature, rather than formal analysis of housing need.

Unlike its low-performing case study counterpart, Alabama, Texas does offer competitive selection preferences for developments that will include units with rents set at a level within the means of extremely low income households. Interviews with state officials indicated that the extremely low income preference was introduced into the competitive process by the Texas Legislature. The extremely low income preference is

one that would likely have been advocated by nonprofit housing organizations and housing advocates, among others. These preferences are not popular with members of the real estate industry, as they reduce the potential profitability of tax credit development. Therefore, this particular selection preference is an example of the stakeholder input process likely being responsible for institution of a feature of program implementation not congenial to for-profit developers.

The competitive process in Texas includes a provision to deduct points from applications of developers with a history of noncompliance in properties previously awarded housing tax credits. This formal selection penalty was supplemented last year by the introduction of legal sanctions against developments with noncompliance issues related to either state or federal regulations. These sanctions carry daily fines of up to $500 and are enforced by a newly created legal unit of the Texas Department of Housing and Community Development designed specifically for the enforcement of this provision of state law.

It is interesting to note that while neither of the high-performing principals covered by these case studies includes a penalty for noncompliance in the competitive selection process, both of the low-performing case study states do. This might be explained by past low performance on the part of the state with regard to structure of the competitive process and monitoring activities; otherwise, there might be fewer problems with noncompliance at the present time, and therefore, no need to include

selection penalties as part of the competitive process. An alternate explanation is that noncompliance penalties are regionally popular among several southern states, including Georgia.

As with the other case study states, Texas does not directly commission market studies for proposed tax credit developments. Instead, its state housing agency publishes a list of approved market analysts from which developers may choose.

The competitive selection process in Texas includes a unit cost limitation, although the form of this limitation makes it a partial measure when compared with the high-performing case study states. Unit cost limitations in Texas apply only to the direct costs of construction, which make up only a part of the total development costs eligible for the federal Low Income Housing Tax Credit. The unit cost limitation is expressed on a square footage basis, but a square footage minimum requirement is also imposed based on the number of bedrooms in each unit. Thus, the developer has an incentive to spend on non-construction costs associated with development, such as tax attorney fees, certified public accountants, architects, environmental specialists and other consultants. Further, the minimum square footage requirements combined with per-square-foot cost limitations may reduce the effectiveness of the unit cost limitations by forcing developers to build units larger than they might otherwise propose.

Texas does not provide direct capacity building assistance to nonprofit housing organizations, but does provide some funding for externally provided activities

through its federal HOME block grant funds. Table 19 provides information on the level of nonprofit participation in the Low Income Housing Tax Credit program for the years 2000 through 2004.

Table 19
Texas Nonprofit Participation
As Percentage of State's Annual Tax Credit Allocation

2000	2001	2002	2003	2004
13	14	10	15	37

Source: National Council of State Housing Agencies (2001, 2002, 2003, 2004, 2005)

Nonprofit participation sharply increased between 2003 and 2004. This increase may be attributed to increased capacity among Texas nonprofit housing developers, as well as to competitive selection criteria designed to foster nonprofit participation. While regression analysis results indicated nonprofit participation to be a factor in the effectiveness of states in managing implementation activities in such a way that developers' ability to capture windfall profits through program participation is constrained, requests for tax credit resources as a percentage of those available remained high at more than 234 percent in 2004, the year showing the large increase in nonprofit participation.

Compliance monitoring activities in Texas are divided between in-house compliance staff members who perform desk reviews of required documentation such as tenant income certifications and external organizations providing on-site compliance

monitoring for tax credit properties. The compliance manager for the Texas Department of Housing and Community Affairs noted that there are two different skill sets associated with desk review and on-site monitoring, which requires knowledge of various facets of building maintenance and disability access. While the assumption that separate knowledge sets are needed for the two aspects of compliance monitoring may be well founded, there is no reason why a state could not hire in-house staff possessed of both knowledge sets, even if these knowledge sets were embodied in separate individuals. Therefore, it appears that a choice has been made in Texas to rely on an outsourcing arrangement for on-site compliance monitoring activities. This choice may have been made within the state housing agency, but given the extraordinarily detailed oversight of the agency by the state legislature, it may be that the choice was imposed on the agency by its political principals.

Finally, as with the other case study states, it was not possible to gain information allowing interpretations to be made regarding the flexibility with which compliance monitoring activities are pursued or the rigor of the follow-up process once an instance of noncompliance, is found. As with all other states included in the case studies, Texas officials seemed to feel most comfortable simply asserting that they follow all federal requirements.

Summary

The two low-performing states analyzed in this chapter’s case studies varied in their level of external and internal hierarchy, although they share the trait of politically dominated external hierarchy. Their internal hierarchies are markedly different, in that public managers within the Alabama Housing Finance Authority reportedly exercise a high level of discretion, while public managers in the Texas Department of Housing and Community Affairs are not only forbidden from having oral communications with applicants, the competitive process is managed in detail by the Texas Legislature through state law.

The board in each state is made up of political appointees and has substantial power over the state housing agency through appointment of the executive director and authority to exercise discretion in matters deviating from written policies or procedures, although this discretion is likely less in Texas than in Alabama. Further, each state’s board has significant representation by members of the real estate industry. While these members may be valuable for the technical expertise they bring to the board’s deliberations, they may also provide disproportionate representation for the interests of developers and other real estate industry participants.

Both states provide a selection incentive that assists extremely low income households, although Alabama’s incentive is indirect and relates to combining Low

Income Housing Tax Credit funding with U.S. Department of Agriculture Rural Development rental assistance funds.

Both states provide federal HOME block grant funds to outside entities performing training and technical assistance to nonprofit housing organizations. Nonprofit participation in Alabama may have increased during the 2000 through 2004 period in part due to a state supreme court decision related to housing for persons with mental illness and developmental disabilities. Nonprofit participation in Texas may have been stimulated in recent years by increased participation in formal venues where nonprofit, advocate and citizen input is sought related to Low Income Housing Tax Credit policy implementation issues, as well as through the structure of competitive selection criteria.

Neither state directly commissions market studies for proposed tax credit developments, nor do they impose effective unit cost limitations. Table 20 provides a summary of organizational and managerial control features common to each of the two low-performing states analyzed in this chapter.

Table 20
Common Features of Low-Performing Principals

FEATURE	ALABAMA	TEXAS	COMMENTS
Dominant political hierarchy	Board of Directors membership primarily based on gubernatorial appointment; state law requires that five or more members be part of the real estate industry	Governing Board is appointed by governor with approval by legislature required. Board includes substantial proportion of members of the real estate industry. Legislature prescribes competitive selection process in detail through state law.	Although each of the two low-performing case study states have state housing agencies dominated by a political hierarchy, the level of political involvement is far greater in Texas than in Alabama. Both states have strong board representation by members of the real estate industry. While this may provide the boards with essential expertise, it also has the potential to bias policy priorities and issues related to the competitive selection process in ways that favor for-profit developers.
Staff expertise	Alabama's tax credit manager is one of the most experienced in the U.S.; her colleagues are likewise very experienced.	Managers involved with the day-to-day operations of the tax credit program in Texas are experienced.	While both states appear to have staff members who have the expertise necessary to effectively manage working relationships with developers, their ability to do so is constrained by political oversight. In the case of Texas, these constraints and the level of political involvement in routine decision making are far more pronounced than in Alabama. It is likely that Alabama's state housing agency public managers may be better able to use their expertise to influence the board decision making process than the highly constrained Texas public managers.

FEATURE	ALABAMA	TEXAS	COMMENTS
Selection preferences for extremely low income households	Alabama's selection preferences are indirect and involve federal Rural Development funds.	Texas provides a direct selection preference for proposed developments which will include extremely low income units.	Although the two states differ in their approach to extremely low income housing, both make an effort to address the needs of this difficult-to-serve population group.
State housing agency directly commissions market studies for proposed developments	Alabama does not directly commission market studies, but publishes a list of preferred market analysts.	Texas does not directly commission market studies, but publishes a list of approved market analysts.	
Selection penalties for noncompliance	Alabama uses a scoring penalty for applications submitted by developer-agents with a history of noncompliance in developments previously awarded tax credit funding.	Texas uses a scoring penalty for applications submitted by developer-agents with a history of noncompliance in developments previously awarded tax credit funding	
Unit cost limitations	Alabama does not formally impose unit cost limitations.	Texas imposes formal unit cost limitations, but their structure may not lead to effective cost limitations.	Interviews with Alabama developers revealed that they are aware that they must be cautious with regard to the development cost for units proposed for tax credit funding. In contrast, Texas imposes limitations that are formal, yet incomplete. There appears to be little difference in the effectiveness of these state agencies arising from unit cost limitations.

FEATURE	ALABAMA	TEXAS	COMMENTS
Nonprofit organization capacity building	Alabama provides federal HOME funds to outside organizations that provide training and technical assistance for nonprofit housing organizations.	Texas provides federal HOME funds to outside organizations that provide training and technical assistance for nonprofit housing organizations.	
In-house compliance monitoring	All of Alabama's compliance monitoring activities are performed by state housing agency staff.	Some of Texas's compliance monitoring activities are performed by state housing agency staff.	

This dissertation will conclude with Chapter 7. Chapter 7 provides a contrast between states that performed better than predicted by the regression model and those performing more poorly than predicted in Low Income Housing Tax Credit program implementation. It will also provide policy recommendations and suggestions for future research.

CHAPTER 7

CONCLUSION

This dissertation provided an empirical analysis of the implementation process for the Low Income Housing Tax Credit, a policy tool characteristic of the New Governance. The Low Income Housing Tax Credit is an indirect tool of public action placing substantial reliance on third-party agents for the provision of low-income rental housing throughout the U.S. Further, responsibility for program implementation is devolved upon the states.

Policy tools separating the purchaser from provider of goods and services are increasingly popular; these purchaser-provider relationships place public organizations in the role of principal vis-à-vis third-party agents. Many of these agents are for-profit firms whose goals may sharply differ from those of the public principal responsible for serving the public interest. The complexity of the responsibilities facing the public organization are amplified by the fact that it is accountable for program activities, yet has no formal authority over third-party implementation agents.

Principal-agent theory offers hierarchy as a solution to problems associated with information asymmetry, adverse selection, moral hazard and goal conflict that arise in the agency relationship. For more than twenty years, the typical application of this

theoretical framework to issues of public administration has focused on control of the bureaucracy by the political principal. Although there have been some recent efforts to expand the unit of analysis and recognize the role of public organizations as principals in modern policy implementation, these applications are few (Milward & Provan, 2000, 1998; Waterman & Meier, 1998; Songer, Segal & Cameron, 1994).

Further, the traditional form of hierarchy with a simple employer-employee basis is not available to a public organization managing the activities of a network of private-sector agents. Instead, the effective public organization establishes a hierarchical network through tools that may include structuring the network and managerial control systems (Moynihan, 2005; Milward & Provan, 2000, 19998).

This dissertation is an effort to expand the literature of public administration with empirical evidence regarding public organizations functioning as principals in policy implementation. It included both regression analysis and multiple case studies in an exploratory examination of organizational and managerial factors that may contribute to effective management of private-sector implementation networks by public organizations. Key results, policy recommendations and suggestions for future research are presented in this conclusion.

How Do High- and Low-Performing Principals Differ?

There were two primary differences between states that performed better than predicted and those performing more poorly than predicted in the federal Low Income

Housing Tax Credit program. The first relates to the level of hierarchy imposed on the state housing agency from an external source—in other words, one important difference arose from issues associated with the principal's principal. The second is associated with the professional orientation of the principal's principal.

Regression analysis revealed that direct supervision of the state housing agency by the governor on average *increased* excess requests for tax credit resources by developers. This implies that political oversight of the state housing agency increased developers' ability to exploit the Low Income Housing Tax Credit program and obtain excessive (or windfall) profits. Case study analysis provided further information on how external hierarchy affected state performance, including the impact of political oversight of the state housing agency.

As a state performing better than predicted, North Dakota has--at least to some extent—less external hierarchy than South Dakota, another state with better-than-predicted performance. The state housing agency is not under direct gubernatorial supervision, although the governor does serve on the North Dakota Industrial Commission, which oversees the housing agency. The executive director is empowered to exercise discretion regarding deviations from written policies and procedures. Because the executive director's long-term expertise is in single-family homeownership programs rather than the Low Income Housing Tax Credit or other multifamily rental programs, however, he relies to a great extent on recommendations made by his

agency's director of planning and development. This individual has extensive experience with housing tax credits and other public multifamily programs; therefore, the exercise of discretion in the North Dakota Housing Finance Agency is based on public manager expertise rather than external hierarchy.[23]

South Dakota's housing agency is under the direct supervision of the governor. In contrast to North Dakota's organizational processes, deviations from written policies or procedures are placed before the South Dakota Housing Development Authority's Board of Commissioners for decision making. While the public manager responsible for the tax credit program in South Dakota is experienced and doubtless provides input and perspective when the exercise of significant discretion by the board is necessary, this public manager also emphasized in an interview with the author that the board's membership was very knowledgeable and well able to engage in informed decision making.

One of the states explored through case study that performed more poorly than predicted, Alabama does not feature direct supervision of the state housing agency by the governor. However, the governor appoints the majority of board members who oversee the agency. Deviations from written policies and procedures at the Alabama Housing Finance Authority are the purview of the Board of Directors, although it is

[23] This observation is not intended to be construed to mean that the executive director or other public managers within the North Dakota Housing Finance Agency do not seek approval from the North Dakota Industrial Commission, its governing board, when necessary or appropriate.

likely that the very experienced public managers responsible for the Low Income Housing Tax Credit are asked for their input and perspective prior to board decisions.

By far, the strongest level of hierarchy external to the state housing agency among the case study states is found in Texas, the second of the case study states examined that performed more poorly than predicted. The governor has direct supervision of the Texas Department of Housing and Community Affairs, and further, he or she appoints all seven members of the agency's Governing Board. These board members must be confirmed by the Texas Legislature, thereby involving further political considerations in the appointment process. Political considerations on issues requiring concurrence between governor and legislature may be especially complex in Texas, as it is a weak governor state.

Strong hierarchical control over the actions of the Texas Department of Housing and Community Affairs is also associated with the Texas Legislature's detailed management of the policy priorities and structure of the competitive arena, since these are prescribed by the legislature through state law.

Thus, a high level of hierarchical control over the state housing agency by a political principal appears to be associated with low performance in managing implementation networks. With a program such as the Low Income Housing Tax Credit, this result may arise from at least two factors. First, housing tax credit implementation involves substantial expertise on the part of both public managers

within the state housing agency, as well among developers. Required expertise includes—but is not limited to--broad understanding of housing policy, complex financing mechanisms, architectural design, energy efficiency, the environment, federal Fair Housing requirements, the federal tax code, and accounting methods. Although no single individual within the state agency or on the development team is likely to possess all of these areas of expertise, they must understand how these areas interact and affect the creation and maintenance of housing opportunities for low-income households.

Perhaps as important as the level of hierarchy external to the state housing agency in explaining differences in performance is the professional orientation of those who wield hierarchical power over it. Case studies revealed a distinctive difference between the professional orientation of governing bodies in the high-performing and low-performing states.

Unlike the boards in low-performing states, the governing bodies in North Dakota and South Dakota were not dominated by members of the real estate industry. Instead, their boards included individuals whose primary professional orientation is service to low-income households, either through public sector or nonprofit management positions. In contrast, Alabama's state law requires a certain number of representatives from the real estate industry. Texas's board also includes a significant number of real estate industry representatives. Neither board in the low-performing

states was balanced by strong representation from those whose primary professional responsibilities include working with low-income households.

While the presence of members of the real estate industry may be desirable from the standpoint of expertise necessary to the understanding of financial issues and the development process associated with the Low Income Housing Tax Credit program, their presence may introduce a bias—possibly unintentional—toward the views and preferences of developers in the policy implementation process. Further, boards without members drawn from those who serve low-income households on a regular basis are likely to eliminate the possibility of indirect representation and advocacy for low-income issues based upon the greater understanding of these issues possessed by those whose professional life revolves around them.

In addition, the micro-level involvement of the Texas Legislature in the structure of managerial control tools and the lack of even a small amount of discretionary authority among experienced public managers within the state housing agency implies that negative outcomes may be expected when political control of the bureaucracy is complete.

Other issues affecting the quality of the principal-agent relationship in Low Income Housing Tax Credit implementation include a number of factors revealed through regression analysis and case study. The progression of time tended to reduce relative level of excess demand for program resources by developers. This may arise

from two factors: First, automatic annual increases (apart from those associated with population growth, which were always part of the program's funding formula) in program funding were enacted by Congress late in 2000; they took effect in 2001. Second, state housing agency managers may become more adept at managing the principal-agent relationship over time.

Nonprofit participation had the effect of reducing excess requests for resources by developers. This may be associated with greater congruence between nonprofit organization goals and the state's goals. Where the principal has an opportunity to diversify its team of agents to include those with goals consistent with their own, the ability of for-profit agents to exploit the program and reach their goal of excessive or windfall profits is likely diminished.

The dollar value of new construction activities (scaled per 1,000 population) also appeared to reduce the excess demand for resources by developers. This may be interpreted as an indication that developers will take advantage of conventional opportunities in the private sector when highly profitable opportunities are available.

Other indicators of the economic health or robustness of the housing market as measured by State Gross Domestic Product per 1,000 population and the federally determined state Housing Price Index were not significant in predicting the behavior of developers in the Low Income Housing Tax Credit program. Organizational form of the state housing agency also failed to be significant in regression analysis.

An application of case study methods revealed a difference between high- and low-performing states in terms of managerial control associated with unit cost limitations. Both North Dakota and South Dakota integrate explicit limitations on the costs of development into the competitive selection process, although their technical means for doing so are somewhat different. Alabama does not publish specific unit cost limitations, although developers reported they felt the state housing agency management had a number in mind. Texas's competitive process includes a unit cost limitation component, but the limitation is only partial in nature; it does not involve total development costs.

Table 21 provides a summary of factors affecting state in Low Income Housing Tax Credit implementation.

Table 21
Primary Factors Affecting Public Organization Performance in Low Income Housing Tax Credit Implementation

FACTOR	HIGH PERFORMANCE	LOW PERFORMANCE
Strength of Hierarchy Imposed by Principal's Principal	High-performing states appeared to have less hierarchy imposed by a source external to the state housing agency and provided greater opportunity for reliance on technical expertise possessed by public managers within state housing agency	Low-performing states appeared to have state housing agencies more hierarchically managed by an external body than high performers. Although public managers within the state housing agencies in these states possess significant experience and expertise, there may be less opportunity for reliance on this expertise, owing to the strength of the hierarchy imposed by an external source.
Professional Orientation of Principal's Principal	The principal's principal in high-performing states was not dominated by members of the real estate industry. In contrast to low-performing states, governing bodies included significant representation by professionals whose primary work focuses on service to low-income households.	The principal's principal for low-performing states was dominated by members of the real estate industry. Further, the nature of the appointment process in these states appeared to rely more heavily on political considerations than in high-performing states.

FACTOR	HIGH PERFORMANCE	LOW PERFORMANCE
Time	On average, the passage of time reduced the capacity of developers to obtain windfall profits. The effect of time was more pronounced in high-performing states.	On average, the passage of time reduced the capacity of developers to obtain windfall profits. The effect of time was less pronounced in low-performing states.
Nonprofit Participation	On average, nonprofit participation had the effect of reducing developers' ability to capture windfall profits. The average level of nonprofit participation for the period 2000 through 2004 was greater in high-performance states than in low-performance states.	On average, nonprofit participation had the effect of reducing developers' ability to capture windfall profits. The average level of nonprofit participation for the period 2000 through 2004 was lower in Texas than in high-performance states. Alabama's average nonprofit participation for the five-year period was strongly affected by a state supreme court decision requiring the state housing agency to fund housing for persons with mental illness or developmental disabilities.
Other Development Opportunities	On average, the presence of conventional development opportunities outside the Low Income Housing Tax Credit program appears to have diminished developers' ability to capture windfall profits. This result was more pronounced for high-performing states than for low-performing states.	On average, the presence of conventional development opportunities outside the Low Income Housing Tax Credit program appears to have diminished developers' ability to capture windfall profits. This result was less pronounced for low-performing states than for high-performing states.

FACTOR	HIGH PERFORMANCE	LOW PERFORMANCE
Limitations on Development Unit Costs	High-performing case study states designed and implemented effective limitations on total development costs on a per-unit basis.	Low-performing case study states either failed to specify limitations on development costs or applied such limitations to only a portion of total development costs.

Policy Recommendations

The federal Low Income Housing Tax Credit program is a policy tool reliant on a quasi-market system of competition within states to produce rental housing opportunities for low-income households. Unlike programs such as the Housing Choice Voucher program, this policy was not carefully designed, nor has it ever had an evaluation that includes examination of actual program outcomes for tenants who reside in these units (Orlebeke, 2000). Instead, program success is typically propounded based on the number of units produced (Jackson, 2006).

Further, the sociopolitical environment characteristic of the New Governance and the New Public Management includes the assumption that collaboration necessarily produces superior results to other methods of policy design or public service (McGuire, 2006). While collaboration has the capacity to foster common norms and goals across diverse network participants (Milward & Provan, 2000), there is no evidence of this type for the Low Income Housing Tax Credit program.

Therefore, policy recommendations include an evaluation initiative to be initiated at either the federal or state level that includes explicit consideration of outcomes for the low-income households the program is intended to serve. This evaluation should also consider the extent to which redistribution of public dollars benefits tenants versus the developers and syndicators involved with program implementation. If a centralized evaluation is not feasible for either political or financial reasons, then individual states can and should perform an evaluation of program outcomes in their own state. Other states may follow states with the will to innovate in evaluation of the Low Income Housing Tax credit program.

In addition, states should be conscious of the level of pluralism present in their Low Income Housing Tax Credit policy implementation process. The analysis of four case study states in this dissertation revealed that state housing agency governing boards vary widely in the professional orientation of their members; further, this variation appears to be important in explaining state policy implementation performance. Where low-income households have representation through board members whose work focuses on low-income issues on a daily basis, governing boards may provide more balanced policy guidance and decision making.

Fostering more representative board membership should be supplemented by additional efforts in seeking citizen participation into issues affecting low-income housing. Gaining this citizen participation may require a public education process,

particularly with regard to whom individuals and families are who are served by tax credit housing and other publicly funded programs. Many members of the public may not understand that the vast majority of those served by this housing are working people, retirees or persons with disabilities so significant that they are unable to be full-time participants in the workforce. Public education efforts can be particularly meaningful if they are based on program evaluation efforts that allow states to describe who participates in the program and why, as well as how much of the benefit flows to tenants versus members of the real estate industry.

Finally, citizen participation may also be fostered through carefully constructed surveys administered on a random-sample basis throughout the state. Results of such surveys can be used a starting points for discussion at roundtables, town hall meetings, more traditional public meetings and legislative debate.

Future Research

This dissertation began with a focus on the exploration of how one group of public organizations manage their role as principals in the implementation of a complex and indirect policy tool characteristic of the New Governance. The process of exploration led to the recognition that organizational form and managerial techniques alone are insufficient to determine which public organization principal will have a high performance level and which will have a low performance result.

One of the chief questions raised by this dissertation is whether the assumption that political control of the bureaucracy is a desirable state of affairs is tenable in all situations. This assumption is inherent in traditional applications of the principal-agent model within political science. The perceived merit of political control of the bureaucracy may benefit from an explicit exploration of this issue as it relates to implementation of New Governance-style policy tools, where third-party agents may use political influence to affect the competitive process for resources and other issues of program administration.

Further, the impact of the professional orientation of those serving on boards providing hierarchical oversight of public organization principals bears further examination. Because policy tools characteristic of the New Governance typically involve the grant of relatively high levels of authority and discretion to third-party implementation agents, the professional orientation of the principal's principal may be important in determining the quality of the hierarchical network. Those board members with either strong political orientations or professional orientations similar to those of third-party implementation agents may detract from the public organization principal's ability to effectively manage the principal-agent relationship with third-party agents.

Finally, this research points to the need for additional research related to the role of public manager technical expertise and their ability to use this expertise in the exercise of authority and discretion on behalf of the public organization in which they

serve. Indirect policy tools characteristic of the New Governance typically involve the application of technical expertise, authority and discretion by third-party implementation agents. There is no empirical evidence to date that describes the way in which public managers' technical expertise and exercise of authority and discretion affects the quality of outcomes reliant on third-party implementation efforts.

This dissertation contributes to knowledge in public administration through an exploration of issues associated with the performance of public organization principals in the implementation of a New Governance-style policy tool. It has highlighted the role of hierarchy in managerial quality, not only on the part of the public organization vis-à-vis private-sector implementation agents, but also on the part of those providing hierarchical oversight of the public organization principal. It has also provided insight into the role of nonprofit participation in the policy implementation process, as well as the presence of opportunities for private-sector agents to earn profits through conventional pursuit of their firms' activities, rather than through participation in a public program. Finally, it has underscored the contribution of specific cost controls when working with private-sector agents, particularly when those agents tend to be dominated by a pool of for-profit firms.

In closing, it is important to note that the public managers involved with policy implementation in the Low Income Housing Tax Credit program tend to be experienced individuals possessed of more than adequate levels of expertise. Indeed, it is ironic that

one of the longest-serving and most respected tax credit managers was found in Alabama, one of the low-performing states in this study. The results obtained in each state appear to be more a function of the type and degree of hierarchy imposed by the principal's principal than it does the level of expertise or dedication of individual public managers within state housing agencies.

This recognition has implications for the types of skills and competencies that must be fostered among current and future public managers. Public managers need not only those skills necessary for managing networks of agents, but also skills that will allow them to deal effectively with their principal's principal in the broad and complex policy implementation process of the New Governance.

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