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## Annual Federal Budget Process Starts Anew

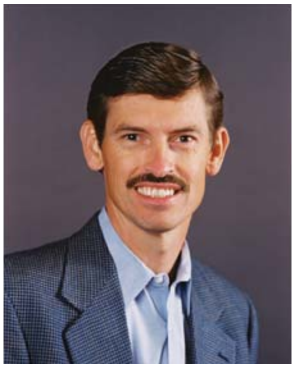
**By Michael J. Novogradac, CPA**

The annual federal budget process starts anew with the release of President Barack Obama's proposed $3.8 trillion budget for 2011. The federal government's fiscal year ends September 30, and every year, in early February, the President submits his proposed budget to Congress. From there, the battles begin as House and Senate committees hold hearings and vote to authorize legislation and appropriate money to operate the federal budget for another year.

President Obama is walking a tightrope as he seeks to inject the nation's economy with huge amounts of cash for job creation and relief from the nation's recession, but simultaneously begins to steer the nation down a course toward deficit reduction. To start down this latter course, the President is proposing to terminate or reduce 126 federal programs, which is expected to generate $23 billion in savings next year and $240 billion over the next 10 years. These terminations and reductions are causing considerable concern in the affordable housing community, but for the community development and renewable energy tax credit communities the proposed fiscal year (FY) 2011 budget provides for some, more of a mixed bag.

Overall, the Obama budget calls for tax cuts for workers and businesses, tax increases on higher-income people, a $300 billion jobs initiative that includes a tax credit of as much as $5,000 for each new worker that businesses hire, and a partial freeze on some domestic programs, including significant funding cuts for the Section 202 Housing for the Elderly and Section 811 Housing for Persons with Disabilities programs.

On the budget's affordable housing side, responses from tax credit industry leaders are somewhat cautious, as they focus initially on the facts of the budget.



National Housing Conference (NHC) President and CEO Conrad Egan, one of the few in the affordable housing industry who at the time of this writing offered a view on the proposed budget, said that the President's proposal provides critical support for affordable housing. "In response to the most severe recession in generations, the Administration's budget proposal balances fiscal responsibility with the need to support many existing and new programs focused on providing decent, stable and affordable housing to families and individuals nationwide at a time when they need it most," he said.

### The Proposed Budget and Affordable Housing

President Obama's proposed budget recommends an extension of the Section 1602 low-income housing tax credit cash grant exchange program created by the Recovery Act. The extension was one of the three consensus proposals that won support from the LIHTC community last year. Unfortunately, the budget proposal does not include the industry's other two consensus proposals: a five-year carryback and changes to passive activity rules. Despite this setback, the consensus group A.C.T.I.O.N. plans to continue to pursue these proposals on Capitol Hill where the Senate is considering a jobs bill. The jobs bill was initially expected to be combined with the

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extension of a number of expiring tax provisions. Senators Max Baucus and Charles Grassley were leading this bipartisan effort, but as we went to press, Majority Leader Harry Reid announced his opposition to this effort. I urge readers to take time to remind Senate Finance Committee members of the jobs potential of these other two proposals and urge them to include them in a jobs tax bill.

## The Budget and the NMTC

It's all good news for the community development industry; the Administration's FY 2011 proposed budget includes an extension of the new markets tax credit (NMTC) through 2011. It calls for $5 billion in each of 2010 and 2011 and would permit the NMTC to offset the alternative minimum tax (AMT). The AMT offset is particularly intriguing, as it would likely open NMTC investments to individuals. The proposed budget provides the Community Development Financial Institutions (CDFI) fund with $250 million, an indication of strong support for the Fund. "It is clear that President Obama is committed to laying the foundations for long-term and inclusive economic growth and prosperity in our nation's most economically distressed communities, and the CDFI Fund is proud to have a leadership role in this effort," said Donna J. Gambrell, CDFI Fund director.

## The Budget and the RETC

President Obama's budget request includes a number of notable investments in clean energy, including a $5 billion expansion of the Section 48C manufacturing tax credit. "We are … pleased to see that the manufacturing tax credit was expanded … along with an extension of bonus depreciation, which is a helpful incentive for many technologies," said Denise Bode, American Wind Energy Association CEO.

In addition, the President's request includes lending authority to support approximately $40 billion in loan guarantees for innovative clean energy programs; more than $108 million for research in the areas of wind, solar and geothermal energies; more than $217 million for science research and discovery; and $300 million for the Advanced Research Project Agency. The Solar Energy Industries Association says the proposal represents a 22 percent increase from last year's spending for solar.

The proposed budget does include several program cuts as well as the termination of some energy subsidies, including the elimination of more than $2.7 billion in tax subsidies for oil, coal and gas.

## The Budget and HUD

The U.S. Department of Housing and Urban Development (HUD) budget reflects an effort to reform its housing and community development programs to make them more streamlined, efficient and accountable, according to HUD Secretary Shaun Donovan.

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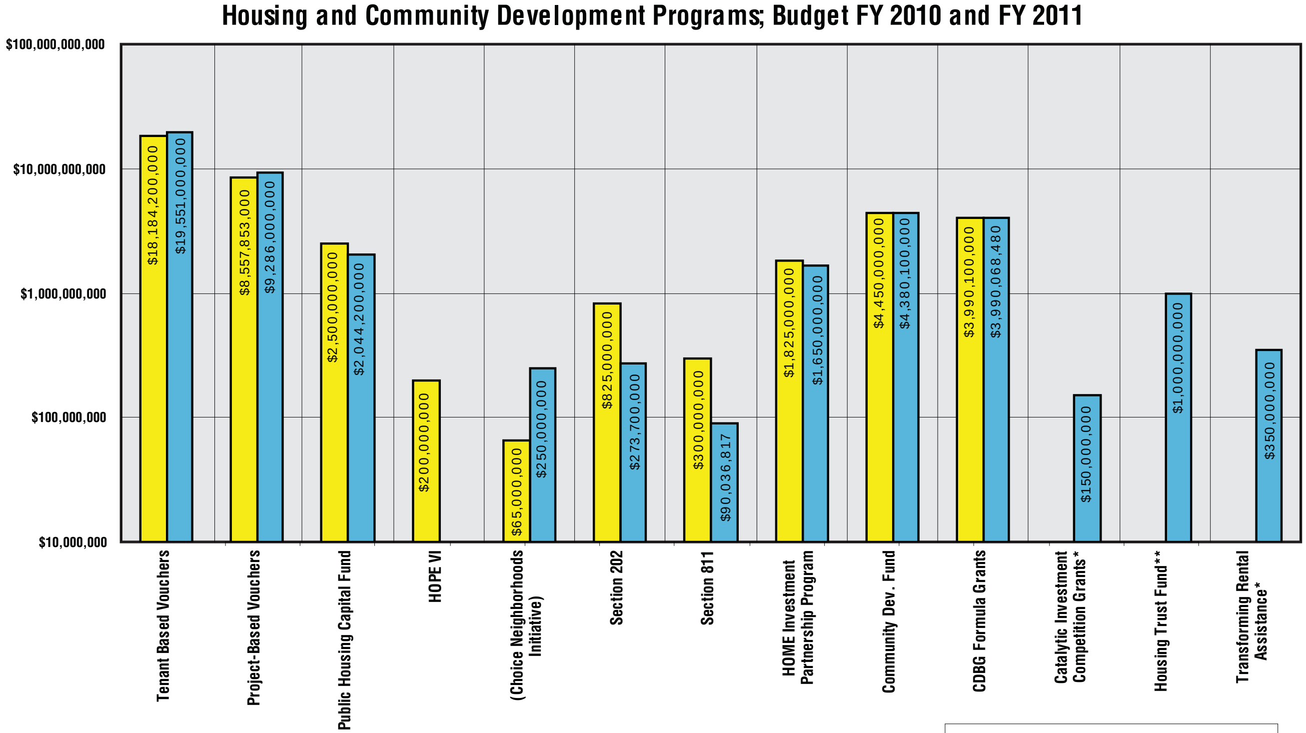


* New funding category in FY 2010
** Authorized mandatory spending program; Has yet to receive funding through legislative proposal; subject to PAYGO.

In our view, the HUD budget also reflects a significant shift from investement assistance to rental assistance, building into future budgets a need to renew more section 8 subsidies, in effect crowding out new investments as budget constraints get much tougher.

Whether the HUD budget for FY 2011 would be cut or increased is open to interpretation. The *New York Times* reported on February 1 that HUD got a big boost in funding during the president's first year but would experience a small cut in the fiscal year beginning October 1. However, as I reported in my February 9 podcast (www.novoco.com/podcast), there may or may not be an actual decrease in HUD's budget — it depends on which accounting approach is used.

HUD's request for $41.6 billion in the FY 2011 budget is 5 percent less than its enacted FY 2010 budget of $43.6 billion. Under this approach, there is a 5 percent reduction in the HUD budget; however, the proposed budget provides $48.5 billion in program funding to support HUD's core programs and new initiatives. The higher funding amount is made possible due to estimated collections of $6.9 billion from credit premiums charged for HUD mortgage insurance and other credit enhancements, namely FHA mortgage insurance. This higher $48.5 billion amount is $1.5 billion more than the prior year. This means that HUD's budget was either reduced by 5 percent or increased by 3 percent, depending on how you measure it.

The 2011 HUD budget which even now is tilted more toward rental assistance versus new capital subsidy, appears to be leaning even more heavily in that direction. It proposes long-term fundamental reforms, including launching a new initiative called Transforming Rental Assistance (TRA). Supporters say TRA will preserve public housing by enabling its owners to address the current and future capital needs of their properties, especially by leveraging private capital. TRA is also expected streamline HUD's 13 separate rental assistance programs and expand housing choices for low-income families. The proposed budget would provide $350 million to preserve approximately 300,000 units of public and assisted housing.

The proposed funding cuts for supportive housing programs would see Section 202 trimmed by 67 percent over 2010 (down $551 million) and Section 811 taking a hit of 70 percent (down $210 million). "Section 202 and 811 are important programs with distinguished histories. However, they are in need of modernization," said Donovan. It is expected that many of the recipients whose funding is being cut would get housing vouchers instead.

The FY 2011 budget again proposes no new funding for HOPE VI, choosing instead to replace the program with the Choice Neighborhoods Initiative, which would receive $250 million. (For more information on the Choice Neighborhoods Initiative, please see The Buzz in the February 2010 issue of the Journal of Tax Credits.)

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### Those Who Will Lose

In addition to those areas mentioned previously that will receive reduced funding are the public housing capital fund, with $2 billion, down from $2.5 billion; Indian housing block grants, $580 million, down from $700 million; and HOME, $1.65 billion, down from $1.8 billion.

The President's FY 2011 budget proposal presents some painful cuts to those of us in the tax credit industries but it also provides new opportunities. As the House and Senate go to work to create their non-binding budget resolutions there are sure to be many and significant changes before a budget resolution is adopted. Let us continue to reach out to congressional members, voicing our industries' needs and concerns, underscoring the good and important work that tax credits have done and can continue to do for individuals, businesses and communities. Novogradac & Company LLP's renewable energy tax credit conference at the end of April in Washington, D.C., and new markets tax credit conference in early June, also in Washington, D.C., provide an opportunity for our readers to have their voices heard on Capitol Hill. Please send us your comments on the President's budget to cpas@novoco.com. We welcome your thoughts.

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