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Testimony Before the Subcommittee on Select Revenue Measures of the House Committee on Ways and Means

May 24, 2007

Mr. Chairman and Members of the Subcommittee:

On behalf of the National Association Local Housing Finance Agencies (NALHFA), thank you for the opportunity to testify today on refinements to the Low-Income Housing Tax Credit program. I am Olson Lee, President of NALHFA and Deputy Executive Director of the City of San Francisco Redevelopment Agency. NALHFA is a national non-profit organization of city and county government agencies and their partners that finance affordable housing through a variety of means including federal tax incentives such as the Low-Income Housing Tax Credit (LIHTC). We appreciate this opportunity to share our views. Supporting my testimony today are the U.S. Conference of Mayors, National Association of Counties, and the National Community Development Association.

The Low-Income Housing Tax Credit program is the federal governments' principal means of stimulating private sector investment in the production of affordable rental housing for low- and very-low income Americans. The tax credit is available in two forms: a competitive 9% or 70% present value credit allocated by state and a handful of local governments and a non-competitive 4% or 30% present value which is used with tax-exempt multifamily housing bonds. With these credits, local and state housing finance agencies, and their private and non-profit partners, produce on average 110,000 newly constructed or rehabilitated units annually. It is an essential resource in the affordable housing tool kit.

In San Francisco, the Redevelopment Agency and the Mayor's Office of Housing has used the tax credit program to construct, acquire, and rehabilitate over 10,000 units including over 2,000 units of housing at-risk of converting to market rate housing, housing for the formerly chronically homeless, workforce housing as part of the City's redevelopment project areas, and rebuilt public housing.

NALHFA urges the Subcommittee and Congress to adopt a number of refinements to the tax credit program. These suggested refinements come from a local housing finance agency's perspective. As local housing finance agencies, we share the responsibility of the gap funder for most affordable housing projects in our communities. But each local housing finance agency works in different markets and needs flexibility in the program to ensure that the credit can help address their particular local housing needs. Thus our suggested refinements are organized as follows: (1) increase the effectiveness of the current credits; and (2) provide for greater flexibility when credits are used with tax-exempt bonds.

Increase Effectiveness for Current Credits

Congress can increase the effectiveness of the credit by eliminating or modifying certain rules related to the use of tax credits with other funding sources. Many of these rules date to the earliest days of the credit program and were incorporated to prevent over subsidizing of a project. Even if the majority of these refinements are adopted, local housing finance agencies would still need to provide additional subsidy to make projects financially feasible. In California, the Tax Credit Allocation Committee conducts subsidy layering reviews which prevents such

over-subsidizing of a project and makes these certain rules duplicative. The suggested refinements include:

Remove the restriction in the tax code that prevents tax credit projects which receive a 9% tax credit, and a below market rate loan from HOME funds, from getting the 30% tax credit bonus that is otherwise available to projects located in a designated low-income census tract or difficult to develop area.

This change would facilitate development in high housing-cost areas.

Modify the tax code to ensure eligibility for the 9% credit projects containing subsidies from all federal programs (e.g. Section 202 elderly and Section 811 housing).

Currently, Section 202 or Section 811 funds and the Federal Home Loan Banks Affordable Housing program funds that are invested in LIHTC projects trigger a reduction in the value of the credit from 9% to 4%.

Other changes that would increase the effectiveness of the credit include:

- Not reduce basis for a Section 236 interest rate subsidy

- Repeal the prohibition against project-based Section 8 Moderate Rehabilitation subsidy

- Eliminate the 10-year ownership rule

- Allow land and land leases as part of creditable basis for projects in high housing-cost areas where land constitutes a larger part of project costs

- Allow the cost of a building as creditable basis at the 9% level for rehabilitation projects in high-housing cost areas, since the building has value

- Allow incomes for existing tenants to go up to 80% of median income for “at-risk” projects

Set the value of the tax credits at 4% and 9%

The current 30% and 70% percent present value causes uncertainty in the marketplace and makes project underwriting difficult.

Repeal the 10% expenditure rule

We are asking for repeal of the requirement that 10% of a tax-credit assisted project’s expected costs be incurred within six months after receiving a credit allocation (or by the end of the calendar year if later) with a requirement that housing credit allocating agencies ensure that projects are ready for implementation. The current rule adds unnecessary costs to the project.

Conform the rule for next available unit between the Low-Income Housing Tax Credit and tax-exempt multifamily housing bond program

Under both the tax credit and multifamily bond programs, tenant income may increase up to 140% of the initial eligible income while still being qualified. If the tenant’s income exceeds 140%, the landlord must rent the next available unit of comparable size to an income-qualified tenant. In the tax credit program, the rule applies to each building in a development, whereas in

the bond program it applies to the full development. In the interest of simplicity, the tax credit rule should conform to the bond rule.

Exempt Low-Income Housing Tax Credits from the Individual and Corporate Alternative Minimum Tax (AMT)

Individual taxpayers subject to the AMT lose nearly all of the tax benefit that they would otherwise receive from these investments. AMT exemption would enable individuals to become a source of capital for the program. According to a study by the National Association of Homebuilders, "…corporations now provide more than 95 percent of all new capital. This in turn has affected the type, size, and location of LIHTC projects that receive funding. In general, corporations invest in large projects ($5 million to $10 million)… There is also some evidence that corporations are reluctant to invest in special needs projects or in projects designed to spur economic or community revitalization. As a result of these factors, corporations tend to invest in large urban and suburban developments.

Because individuals invest much smaller amounts…they are generally associated with smaller projects and base their investment decisions on idiosyncratic characteristics, such as the location of the project, the size of the project or the type of tenants.

Greater Flexibility When Credits are Used with Tax-Exempt Bonds

The next set of refinements pertains to the need for greater flexibility in the use of credits with tax-exempt bonds. When 51% of the cost of a project is funded by tax-exempt housing bonds it is eligible for a non-competitive 4% credit for the affordable units which must equal 20% of the units for those at 50% of median income or 40% of units at 60% of median income.

After meeting the base project affordability requirement, extend eligibility for the 4% credit to units with tenants with incomes up to 80% of median income in communities with severe shortages of housing for this income group

In many high-housing cost urban areas, persons with incomes above 60% of area median cannot find suitable housing to rent. Under this proposal, housing credit allocating agencies would be permitted to award 4% credits to units in a project to be rented to those with incomes up to 80% of median income. However, the project must still target at least 20% of the units for those at 50% of median income or 40% at 60% of median income and demonstrate through a market study that there is a shortage of housing for those between 60% and 80% of median income and that the rents at 30% of 80% are below market. This proposal is intended to facilitate creation of mixed income housing.

Modify the Low-Income Housing Tax Credit to allow housing bond issuers to exchange a portion of a tax-exempt bond allocation for the authority to issue a higher tax credit.

In recent years, Congress has increased the amount of Low Income Housing Tax Credits and the amount of private activity tax-exempt bonding authority. Until recently, when economic conditions led to renewed interest in single family mortgage revenue bonds, many state allocating agencies experienced a surplus of authority for tax-exempt bonds for private activity. With respect to affordable rental housing, however, there has not been an increase in secondary funding (such as CDBG and HOME) to complement the tax credits, which can only partially fund housing developments. This is particularly true of the tax credits generated by tax-exempt bonds.

While it is very attractive to use tax-exempt bonds and then generate tax credits, outside of the basic 9% program, these tax credits are 4% credits and consequently generate less than half the

equity of the 9% credits. As a result, the funding gaps are larger, and without local sources of secondary funding, many projects cannot be done, and valuable resources tax-exempt bonds and 4% credits go unused. This proposal would permit local agencies to forego or trade in tax-exempt bonding authority in order to increase tax credits in a particular project, thereby reducing and possibly eliminating the need for secondary funding.

Example:

Senior Housing Project

- 100 units at $150,000/unit

- Total development cost: $15 million

- In a typical bond issuance, $7.5 million of tax-exempt bonds would be issued with 4% credits and generating approximately $5 million in equity.

- An alternative scenario would be to issue the $7.5 million tax-exempt bonds but also trade in an additional $15 million tax-exempt bond allocation to effectively use up $22.5 million in bonding authority. If tax credits were permitted to be generated by the foregone bond cap, this would have the effect of issuing 12% low income housing tax credits. It would generate an additional $10 million in equity and eliminate the need for secondary funding.

The 12% tax credit scenario is used for illustration purposes only. It is attractive because it eliminates the need for other funding. But the essential idea is to permit the foregone bond cap (whatever the limits) to automatically generate tax credits at the same rate as the bonds used in a project. If properly structured, this concept would give greater flexibility to local issuers, would encourage more complete utilization of a resource that has already been allocated, and would not require any additional expenditure by the federal government.

Modify the Low-Income Housing Tax Credit to allow housing bond issuers to forgo 4% tax credits in exchange for additional bond volume cap.

This proposal is essentially the reverse of the previous proposal. A project would get additional tax-exempt bond authority if it agreed not to take the 4% credit to subsidize its affordable units.

The preceding two proposals parallel the Mortgage Revenue Bond (MRB) program wherein issuers may trade in tax-exempt bond volume cap for the authority to issue Mortgage Credit Certificates.

Rename the Low-Income Housing Tax Credit, the Affordable Housing Tax Credit

This provision was in H.R. 4873 that was introduced in the 110th Congress. This change better describes the nature of the tax credit.

Although not the subject of this hearing there are several proposals affecting housing preservation and the tax-exempt Mortgage Revenue Bond and Multifamily Bond programs that NALHFA urges the Subcommittee to adopt:

Housing Preservation

Provide exit tax relief to encourage owners of affordable housing to transfer such housing to nonprofits who will maintain the long-term affordability of such housing.

In 2002, the Millennial Housing Commission noted that "… [t]he stock of affordable housing is shrinking. Some properties are in attractive markets, giving owners an economic incentive to opt out of federal properties in favor of market rents,and many owners have done so. Other properties are poorly located and cannot command rents adequately to finance needed repairs. In general, properties with lesser economic value are at risk of deterioration and, ultimately abandonment, unless they can be transferred to new owners. To remove an impediment to transfer, the Commission recommended… that Congress enact a preservation tax incentive [i.e. relief from exit taxes] to encourage sellers to transfer their properties to nonprofits." Exit tax relief would be a tremendously helpful in preserving affordable housing in urban and rural areas.

Tax-Exempt Bonds

Exempt Tax-Exempt Bonds from the Individual and Corporate Alternative Minimum Tax (AMT).

Taxpayers subject to the AMT lose all of the tax benefit that they would other wise receive from these investments. General obligation bonds, Liberty Bonds for New York City's recovery from 9/11, and the GO Zone bonds for Gulf Coast recovery are not subject to the AMT. According to testimony before the House Select Revenue Measures Subcommittee, a representative of The Bond Market Association stated that the AMT adds 15-25 basis points to the borrowing costs of issuers of private activity bonds. An exemption was included in H.R. 4873 that was introduced in the 110th Congress.

Repeal the Mortgage Revenue Bond's "ten year" rule which prevents the recycling of single-family mortgage prepayments ten years after the bonds were issued to make loans to additional first-time homebuyers

This repeal was included in H.R. 4873 that was introduced in the 110th Congress. It also passed the Senate in 2004, but it was rejected by a House-Senate conference committee.

Permit the recycling of multifamily bonds as is permitted for single family bonds under the Mortgage Revenue Bond (MRB) program.

Under the Mortgage Revenue Bond program, issuers may use mortgage prepayments or non-originations to make new mortgages as long as they are used within 10 years of the bond's original issuance. Prepayments of tax-exempt multifamily bonds are not able to be recycled into new mortgages. This would allow issuers to stretch limited bond volume cap thereby assisting additional lower-income renters. The refunding bonds would be subject to a TEFRA hearing and would require corresponding changes in the tax credit program to permit projects to qualify for 4% credits.

Eliminate the current law requirement that issues designate a specific use for bond volume cap that is carried forward.

This requirement has caused some NALHFA members to lose the amount carried forward because of a change in the housing market. As an example the City of Chicago lost $80 million in volume cap that it carried forward for multifamily housing. There was insufficient demand for multifamily bond cap at the same time that the demand for single family bond cap was exploding.

Treat displaced homemakers, single parents, and homeowners who are victims of presidentially-declared disasters as first time homebuyers for purposes of the Mortgage Revenue Bond program

This repeal was included in H.R. 4873 that was introduced in the 110th Congress. In addition, Congress waived the first time homebuyer requirement for victims of Hurricanes Katrina, Rita and Wilma, presidentially-declared disaster areas.

Mr. Chairman, thank you for the opportunity to present NALHFA's recommendations on these critical housing issues.