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

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Thank you, Congressman Neal, Ranking Member English and members of the Subcommittee for this opportunity to testify on strengthening the Low Income Housing Tax Credit and other tax incentives for affordable housing. I am Jonathan Rose, president of Jonathan Rose Companies.

Our firm collaborates with cities, community development corporations, academic and other institutions to help them solve complex development problems. Often this involves building affordable housing or institutional buildings, and all of our work aspires to be as green as it can be with limited budgets. We bring to this testimony a deep commitment to repairing the fabric of our communities and the practical experience of our long term engagement in this work.

Affordable housing is at the core of our development work, often as part of larger mixed-use developments. Our firm is actively engaged in the development of a variety of mixed-use, urban infill, public housing revitalization and senior housing projects. We currently have seven Housing Credit projects in process in locations ranging from the heart of Harlem to downtown Albuquerque.

Among my volunteer affiliations I am a Trustee of Enterprise Community Partners, which has been an active advocate of the Housing Credit since its founder Jim Rouse and chairman Bart Harvey helped Congress create the program in 1986. Enterprise Community Investment, a subsidiary organization, is a major participant in the Housing Credit program, having raised more than $6 billion to support nearly 1,500 properties with more than 83,000 affordable housing units under asset management. Enterprise has pioneered use of the Housing Credit to serve special needs populations and advance healthier and more energy efficient development through the Green Communities initiative.

I will not go into exhaustive detail about the effectiveness, efficiency and importance of the Housing Credit program. Others from whom the Committee will receive testimony will likely cite the overwhelming evidence of the Credit's singular achievements among affordable housing programs.

Suffice to say that from my perspective as a socially motivated for-profit developer of affordable housing, and for my firm and many not for profit community partners, the Housing Credit is the single most important resource available to enable developers to create decent affordable homes for people who need them most. The Housing Credit elegantly joins private market discipline with public purpose and for the most part strikes the proper balance between flexibility and appropriate statutory requirements to help achieve a critical social objective.

Worsening Affordable Housing Needs

It is worthwhile to examine even the most successful public policy from time to time to determine whether market conditions, social needs and on the ground experience suggest modifications may be in order. The Housing Credit statute has not been significantly amended since 2000, when Congress made several important improvements while substantially expanding the program. The time has come to expand the credit again in the context of additional enhancements to further strengthen its ability meet pressing housing needs, for three central reasons.

First, affordability problems for low-income renters are worsening. The number of households paying more than half their incomes for rent increased by more than two million to a record 15.8 million between 2001 and 2004. Nearly two-thirds of this increase in severe cost burden was borne by households in the bottom income quartile, earning less than $22,540.[i] We are now seeing large investment funds purchasing affordable housing, and investing in it, but raising rents beyond the reach of low-income families.

Second, the supply of affordable apartments available to these households is shrinking. More than one million units affordable to the very poor were lost between 1993 and 2003. According to the Harvard University Joint Center for Housing Studies, "the shortage of rentals available and affordable to low-income households was a dismal 5.4 million."[ii] At the same time, construction costs have increased dramatically, raising the cost per unit built. Thus the credit itself is producing fewer units each year.

Third, rising energy and transportation costs are exacerbating the effects of housing challenges and are linked to detrimental health and environmental impacts. A recent national study documented the brutal choices that poor families make when faced with unaffordable home energy bills. The study found that during the prior five years, due to their energy bills: 57 percent of non-elderly owners and 36 percent of non-elderly renters went without medical or dental care; 25 percent made a partial payment or missed a whole rent or mortgage payment; and 20 percent went without food for at least one day.[iii]

In addition, energy costs have increased much faster than incomes for low-income households in recent years. Today a family earning minimum wage pays more than four times as much a share of their income for energy as a median income household.

Transportation costs consume a large share of low-income family budgets as well. A study of 28 metropolitan areas found that families with incomes between $20,000 and $50,000 spend an average of 29 percent of their income on transportation and an average of 28 percent on housing.[iv]

These sobering statistics and the severe human and community needs they reflect call for another expansion of the Housing Credit. Congress should act immediately to increase the program by at least 50 percent, with a priority for states and cities with the most acute housing supply shortages and the most innovative strategies for addressing them holistically and sustainably.

Even an expanded and improved Housing Credit cannot be expected to solve our country's affordable housing crisis on its own, however, especially with the huge projected increase in population -- 100 million over the next generation. We need much greater investment in rental housing assistance and other production programs and a more holistic housing policy that supports smarter land use, more sustainable development, greater transit access and healthier, higher performing buildings.

In fact, housing, transportation and environmental policy should be integrated and funded to a much greater extent at all levels of government. Smarter land use policies are part of the answer to global climate change, as well challenges faced by low-income people and communities. (For the Subcommittee's reference I have attached a list of policy recommendations in the area of transportation and affordable housing.)

Several improvements to the Housing Credit would make it a more effective resource in the context of broader policy changes.

Recommendations for Improving the Housing Credit

Enable the Credit to better serve especially vulnerable populations. The Housing Credit has proven to be an effective resource for creating affordable homes for extremely low-income families and people with special needs, such as the frail elderly, the homeless and individuals with HIV/AIDS, in part because the program generally works well with some other funding sources that help those members of our society pay their rent and enables building owners to keep properties in good shape. Internal Revenue Service rules are unnecessarily constraining the Housing Credit from achieving this purpose even more effectively. Some background is important to provide.

Section 42(d)(5)(A) of the Internal Revenue Code provides that the amount of Housing Credits awarded to a building is reduced to the extent of any grant of federal funds made with respect to the building or operation thereof. Citing legislative history that "Congress did not intend to treat federal rental assistance payments as grants" the Treasury Department issued regulations in 1997 [Treasury Regulations §1.42-16(b)] excluding from the definition of federal grant certain rental assistance payments made to a building owner on behalf of a tenant.

Payments are excluded therefore if made pursuant to: (1) Section 8 of the United States Housing Act of 1937 ("the Act"); (2) A qualifying program of rental assistance administered under Section 9 of the Act; or (3) A program or method of rental assistance as the Secretary may designate by publication in the Federal Register or in the Internal Revenue Bulletin.

Following up on that regulation, the Service has subsequently issued guidance excluding three other rental assistance programs from the definition of federal grant, including: payments made to building owners under the Section 8 Assistance for the Single Room Occupancy Dwelling Program; the Shelter Plus Care Program; rental assistance payments under the Housing Opportunities for Persons with AIDS Program; and rental assistance payments under the Section 236 program and under Section 101 of the National Housing Act.

Those rulings were based on specific requests by affected organizations. Meanwhile, a number of other federal housing programs providing rental assistance under substantially identical rules have not received clearance from the IRS, and there is some confusion whether they could be considered a federal grant.

In addition, there are other programs that provide operating assistance to enable Housing Credit properties to rent units to the lowest income tenants at rates they can afford. These operating subsidies are economically equivalent to rental assistance payments and should be treated the same for purposes of determining whether they are federal grants under section 42(d)(5)(A). The purpose of the federal grant rule is to prevent credits from being awarded on construction costs that are not paid by the owner of the property, but that are instead covered by a federal grant. While that rule should not be changed, it should not apply to operating subsidies that are designed to make the property affordable to the lowest income tenants.

Congress should modify section 42(d)(5)(A) to specifically provide that the following subsidies are not considered to be federal grants: rental assistance payments, operating subsidies, interest subsidies and other ongoing payments to a housing property designed to reduce cash flow needs from rent to enable the property to be rented to the lowest income tenants. This seemingly "technical" change would dramatically improve the Housing Credit's effectiveness in assisting families and individuals who are homeless, elderly, disabled, occupy older assisted housing where continued affordability is threatened or reside in Native American communities

Enhance the Housing Credit's capacity to help create community space. Under the statute Housing Credits are provided for the cost of those units of a property that are rented to qualifying low-income tenants. Housing credits can also be claimed for the cost of common areas used by residents in the property, such as hallways and lobbies. In addition, under current law [Section

42(d)(5)(A)] Housing Credits can cover the cost of a limited amount of space known as "community service facilities." This is space that can be used for such purposes as child care, Meals-on-Wheels, elderly care programs and other similar activities.

The law limits community service facilities to 10 percent of the eligible basis of the property. In addition it requires that the space be designed primarily to serve individuals who otherwise meet the income requirements for living in the property, even if they are not residents of the property.

The community service facility rule deals with a serious problem in many low-income communities: the lack of public space for activities that serve the community such as programs for the children and the elderly. The 10 percent limitation in current law is unduly restrictive and prevents the construction of sufficient space in many smaller Housing Credit properties.

To solve this problem, Congress should increase the space limitation in Section [42(d)(4)(C)(ii)] from 10 percent of eligible basis to 20 percent of eligible basis on the first $5 million of eligible basis, and 10 percent on the basis above $5 million.

<u>Encourage energy efficiency and transit access through the Housing Credit</u>. Current law allows a 30 percent higher credit amount ("basis boost") for developments located in areas where at least half the households have incomes below 60 percent of area median income; where construction, land and utility costs are high relative to average incomes; or where the poverty rate is 25 percent or greater [Section 42(d)(5)C)]. This policy recognizes that certain kinds of Housing Credit developments need additional funding to be feasible. (In fact, the House Credit must typically be supplemented by state and city subsidies to work in most parts of some large urban areas such as New York City.)

More affordable housing developers are recognizing that construction and rehabilitation practices that create healthier, more energy efficient developments and implement site planning that enhances access to transit can deliver significant economic benefits to properties as well as residents.

Achieving meaningful levels of energy efficiency or securing sites near transit can result in higher development costs. These costs are typically paid back from energy savings and result in better outcomes for tenants. However many affordable developers are unable to incur even marginally higher costs to realize these benefits, due to the scarcity of funds for affordable housing overall. Congress should allow a 30 percent basis boost and the necessary volume cap to pay for it for Housing Credit developments that incorporate cost-effective, comprehensive criteria resulting in healthier, higher performing and more environmentally sustainable developments.

A proven and workable reference standard Congress could use are the Green Communities Criteria. The Criteria are the only national standard for healthy, efficient, environmentally friendly affordable homes. The Criteria were specifically designed to maximize the health, economic and environmental benefits of sustainable development for low-income people on a cost-effective basis for developers.

The Criteria were developed by Enterprise, the Natural Resources Defense Council, the American Institute of Architects, the American Planning Association, the National Center for Healthy Housing, Southface, Global Green USA, the Center for Maximum Potential Building Solutions and experts associated with the US Green Building Council.

There are more than 180 Green Communities developments with more than 8,000 affordable units in various stages of development in 23 states. These include new construction, rehab and preservation developments; urban, small town and rural developments; and developments serving families, the elderly and people with special needs. Enterprise's initial assessment indicates that total development costs can be 2 percent to 4 percent higher on average for projects that meet Green Communities Criteria compared to projects that do not deliver the same health, economic and environmental benefits.

The Green Communities Criteria are also the basis for policymakers at all levels of government committed to more environmentally responsible housing and community development policies for low-income people. More than 20 states and cities have used the criteria to ensure their housing programs support healthier, more energy efficient and more environmentally responsible development.

By the way, similar criteria could be applied to Multifamily Housing Bonds, which are often used in combination with Housing Credits. More broadly, Congress should consider ways to increase energy efficiency in all facilities financed by Private Activity Bonds, such as ensuring projects meet the efficiency standard of the federal Energy Star program and providing additional authority for projects that exceed a minimum standard.

There are a number of other worthy proposals for strengthening the Housing Credit that others have put forward. My suggestions are not intended to be exhaustive, but rather to reflect recommendations particularly designed to strengthen the Housing Credit's ability to meet the needs of some of our society's most vulnerable members and do so in ways that create healthier and more environmentally sustainable homes and communities

A New Proposal to Increase Energy Efficiency in Affordable Housing

My testimony concludes with a recommendation developed by Enterprise. While a new proposal, it is in the sprit of this hearing to improve tax policy to support affordable housing. The proposal would complement the Housing Credit and fill a gap in the housing finance system, and the Tax Code, while encouraging greater energy efficiency on a cost-effective basis.

Increasing energy efficiency in affordable multifamily housing delivers several important benefits. These include lower utility costs for low-income residents, more stable operating reserves for building maintenance, better building performance and reduced carbon emissions.

Significant improvements in energy efficiency are achievable for only slightly higher costs than would be the case for projects that do not deliver these benefits. Based on Enterprise's experience through a portfolio of more than 180 energy efficient affordable developments around the country, Enterprise estimates these costs to be between $2,000 and $3,000 per unit, on average, with some variability by location, project type, developer capacity and other factors.

As discussed, current affordable housing subsidies do not provide sufficient resources to cover the incremental costs of achieving high levels of energy efficiency in affordable multifamily developments. Current tax incentives for energy efficient buildings generally are not applicable or appropriate for affordable housing developments. In other words, while the Tax Code encourages energy efficiency in most other major building types, it offers no such incentive for affordable rental housing developments.

The solution is a one-year federal income tax credit to owners of affordable rental properties for eligible costs to achieve a significant reduction in energy in the building. The standard would be the American Society of Heating, Refrigeration and Air Conditioning (ASHRAE) Standard 90.1-2004 plus 20 percent or its equivalent . This is the standard for the federal Energy Star for multifamily buildings program currently under development by the Environmental Protection Agency and Department of Energy.

To tie public subsidy directly to public benefit and to limit the cost to the federal government, *the tax credit would provide only enough subsidy to cover the incremental costs associated with energy efficiency improvements that would not otherwise be feasible*, i.e., only up to an additional $3,000 per unit in costs.

Taxpayers would claim the credit the year the building was placed in service and its energy performance verified through a similar process for claiming the current law energy efficient home credit (Section 45L). The credit would not be allocated but could be subject to an overall annual cap on authority. The credit would not reduce eligible basis for the purpose of claiming Housing Credits or other available federal tax benefits. Additional aspects of the proposals would ensure it could also support non-Housing Credit developments

I suspect that this proposal would have a very small revenue impact, yet generate significant benefits for low-income residents and operators of affordable rental housing. Enterprise and I would look forward to working with members of the Subcommittee and full Committee to further refine and enact this proposal.

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[i] Joint Center for Housing Studies of Harvard University, *The State of the Nation's Housing 2006*, (Cambridge, MA: Joint Center for Housing Studies of Harvard University), p. 25.

[ii] Ibid, p.24.

[iii] National Energy Assistance Directors' Association, *2005 National Energy Assistance Survey*, (Washington, DC: National Energy Assistance Directors' Association, 2005), pp. i-iv.

[iv] Barbara J. Lipman*, A Heavy Load: The Combined Transportation Burden of Working Families*, (Washington, DC: National Housing Conference Center for Housing Policy, 2006) p.1.