January 15, 2014

Chairman Max Baucus
Committee on Finance
U.S. Senate
219 Dirksen Building
Washington, DC 20510

Dear Chairman Baucus:

The LIHTC Working Group was established to provide a platform for a wide variety of low-income housing tax credit ("LIHTC") industry participants to work together to resolve technical and administrative LIHTC program issues. On behalf of the members of the LIHTC Working Group, we respectfully would like to submit comments on your recently released cost recovery and tax accounting discussion draft, as comprehensive tax reform is being considered.

The members of the LIHTC Working Group strive to make the LIHTC program even more efficient in delivering benefits to help build affordable rental housing throughout the nation in wide variety of different housing markets. Our group includes nonprofit and for-profit developers, property managers, lenders, syndicators, investors, accountants and lawyers. We understand the efforts of the Senate Finance Committee to streamline and simplify the Internal Revenue Code, and we hope to engage the Committee in a continuing dialogue on the benefits of the LIHTC while the Congress considers tax reform, as well as the importance of retaining the LIHTC as a permanent part of the Code.

As a key principle underlying tax reform simplification, we understand the desire of the Committee to broaden the tax base in its reform proposals. However, we urge the Committee not include proposals that would damage the nation's primary and most successful affordable rental housing production and preservation program, the LIHTC, which has financed over 2.6 million affordable rental homes since its creation as a result of the last major tax reform effort, the Tax Reform Act of 1986.

One of the base-broadening proposals in the recently released cost recovery and tax accounting discussion draft involves moving to an alternative depreciation system under which property is depreciated over longer periods. More specifically, the proposal lengthens the depreciation period for residential rental real estate from 27.5 to 43 years, and modifies the depreciation method and life for site improvements and personal property. For site improvements, the proposal shifts from a 150 percent declining balance depreciation over 15 years to an annual depreciation deduction of 5 percent of the adjusted basis of the pool. Similarly personal property moves from double declining balance over 5 years to an annual depreciation deduction of 18 percent of the adjusted basis of the pool. The pooling concept effectively lengthens the depreciable life of site improvements from 15 years to well beyond 30 years, and personal property from 5 years to well beyond 10 years.

Each of these depreciation changes would have a negative impact on LIHTC investor yields, investor equity pricing, and the amount of equity raised. To gauge the effect of lengthening rental residential real estate depreciation to 40 years, site improvements to 20 years and personal property to 9 years. Novogradac & Company LLP conducted an analysis included in the attached report, *Affordable Rental Housing after Tax Reform: Calculating Corporate Tax Reform's Possible Effects on Equity Raised from Low-Income Housing Tax Credits*, which provides a detailed analysis of the possible effects on the

amount of equity that can be raised from the LIHTC if current efforts to enact corporate tax reform are successful. The analysis found that for the LIHTC equity market as a whole, there could be a potential annual loss of $220 million to nearly $1 billion dollars, or more, in equity used to finance affordable rental housing.

Novogradac & Company LLP recently used a similar model in the report analysis to estimate the effects of the discussion draft changes, and determined that the depreciation changes would reduce LIHTC investor yields by as much as 20 percent and LIHTC pricing by as much as 9 percent for future developments. Such an adverse impact would lead to a potential loss of LIHTC equity more than $1 billion.

We do not believe that there is clear evidence demonstrating that 43 years is an appropriate economic life for residential rental real estate buildings. In their comprehensive report, *Analysis of Economic Depreciation of Multifamily Property*, authors Jeffrey D. Fisher, Brent C. Smith, Jerrold J. Stern and R. Brian Webb found that rental housing had an economic life of 30.5 years, adding that lower than expected inflation helped to extend the economic life of rental housing properties from what was expected in 1986 when the change to 27.5 years was enacted.

Congressional Research Service Senior Specialist in Economist Policy Jane Gravelle argued in a 2000 report that the depreciation period for structures should be *shortened* to 20 years to "restore equal tax treatment" compared to the depreciation period for equipment.

Furthermore, it is important to note that our report documenting the adverse effect of lengthening rental housing depreciation on the LIHTC analyzes the *prospective* impact of tax reform proposals on future developments. The discussion draft proposes a *retroactive* change to depreciation, affecting millions of existing LIHTC-financed affordable apartments as well as future ones, further damaging the finances of LIHTC properties. The recent analysis found for existing developments, which were underwritten and financed assuming the current law depreciation rates, investor yields would be reduced by as much as 9 percent and equivalent pricing by 3 percent.

The rental housing market is already facing concerns about the effect of lower tax rates on multifamily housing finance in the future, which is already having some impact, but any retroactive changes would be even more chilling. In light of this impact, we strongly urge the Committee ***not*** to make any retroactive changes to tax lives, particularly for transactions where Congress created a targeted tax incentive to encourage tax-motivated investment. Congress made such an exception for low-income housing when they enacted the passive activity rules in the Tax Reform Act of 1986. In the *General Explanation* of the Act, it noted:

> *Transition relief is provided to low-income housing activities. Losses from certain investments since 1983 in low-income housing are not treated as from a passive activity, applicable for a period up to 7 years from the taxpayer's original investment.*

The loss of this equity resulting from these depreciation changes would lead to less affordable rental housing at a time when it is needed throughout the country. Because of a nationwide growing shortage of affordable rental housing, today over a quarter of all renters pay more than half of their income in rent, according to the December 2013 *America's Rental Housing* report from the Harvard Joint Center on Housing Studies (JCHS). Devoting so much family income to housing can be a destabilizing force for many households, leaving insufficient income available to meet basic needs for food, health care, education and transportation. This contributes to residential instability, undermines educational achievement and impairs employment potential.

Furthermore, JCHS found there were only 6.9 million affordable apartments for 11.8 million renters earning at or below 30 percent of the area median income (extremely low-income) nationwide in 2011. This affordability gap is exacerbated by 2.6 million higher income households competing with low-income renters for affordable units, as well as by widespread structural inadequacy in affordable housing stock. As a result, there exists only 36 adequate, available, and affordable rental homes for every 100 extremely low-income households in the United States. The gap between affordable apartments and low-income renters in need of housing continues to widen each year, and the LIHTC is the only significant source of capital to address this need. Indeed, the JCHS report notes:

> *The Low Income Housing Tax Credit program has been the primary source of funding both development of new low-income housing and preservation of existing subsidized properties since 1986…In considering which tax expenditures to rein in, it will be important to recognize the LIHTC program's exceptional track record and its unique role in adding to the affordable housing supply.*

We appreciate the opportunity to submit our comments to you to explain the impact of tax reform proposals on the LIHTC, and we thank you in advance for your time and consideration.

Please do not hesitate to contact Peter Lawrence at Peter.Lawrence@novoco.com or (202) 288-0482 if you have any questions regarding our comments or if we can be of further assistance.

THE LIHTC WORKING GROUP

Very truly yours,

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