Testimony on the
Impact of the Administration's Dividend Exclusion Proposal
on the Low Income Housing Tax Credit
before the
House Committee on Ways and Means
by
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on behalf of the
National Council of State Housing Agencies

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Mr. Chairman, Representative Rangel, and members of the Committee, thank you for the opportunity to testify on the impact of the Administration's dividend exclusion proposal on the Low Income Housing Tax Credit (Housing Credit) and the affordable rental housing production it makes possible.

I am Richard Godfrey, executive director of the Rhode Island Housing and Mortgage Finance Corporation. I am testifying on behalf of the National Council of State Housing Agencies (NCSHA). I serve as NCSHA's vice president.

NCSHA is a national nonprofit, bipartisan organization. It represents the housing finance agencies (HFAs) of the 50 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands.

NCSHA's member agencies administer the Housing Credit in every state. We also issue tax-exempt private activity housing bonds (Bonds) to finance Housing Credit apartments, other affordable rental housing, and first-time homes for low-income families.

NCSHA is deeply grateful to this Committee and the Congress for its steadfast support of the Housing Credit and Bonds. Over 85 percent of the Congress, including most members of this Committee, cosponsored legislation enacted just over two years ago to increase Housing Credit and Bond authority by nearly 50 percent annually. An even greater percentage cosponsored legislation making both programs permanent in 1993.

Eighty-two percent of the last Congress, including 34 members of this Committee, cosponsored Representatives Amo Houghton (R-NY) and Richard Neal's (D-MA) Housing Bond and Credit Modernization and Fairness Act, H.R. 951. We urge you to include this bill, re-introduced by Representatives

Houghton and Neal this year as H.R. 284, in the tax bill you are preparing to write.

H.R. 284's enactment would extend the reach of the Housing Credit and Bonds by repealing the Mortgage Revenue Bond (MRB) Ten-Year Rule, updating MRB purchase price limits, and making Housing Credit income eligibility rules more flexible. The Ten-Year Rule alone is costing states over $3 billion annually in MRB mortgage money that would otherwise be available to help working families buy their first home. California forfeits over $1 million a day to the Ten-Year Rule.

<u>The Unintended Adverse Impact of the Dividend Exclusion on the Housing Credit</u>

NCSHA does not oppose the Administration's Growth and Jobs Plan or the dividend exclusion proposal it contains. We have no position on either. NCSHA also does not believe the Administration intends any harm to the Housing Credit or affordable rental housing production.

We are deeply concerned, however, that Housing Credit apartment production would be severely curtailed if Congress enacts the dividend exclusion as the Administration has proposed it. Ernst & Young's (E&Y) just-released study, *The Impact of the Dividend Exclusion Proposal on the Production of Affordable Housing*, substantiates our concern.

NCSHA commissioned the E&Y study to back up with sound, objective analysis our belief that Housing Credit apartment production would be eliminated or severely reduced as a result of the enactment of the dividend proposal. We have shared the report with the Committee and ask that it be made part of today's hearing record.

E&Y estimates that 40,000 fewer Housing Credit apartments would be produced annually if the dividend exclusion were enacted as currently structured. That means 35 percent of annual Housing Credit apartment production would be lost. And, about 80,000 low-income residents would not be served.

NCSHA fears the total impact may be much greater. E&Y does not take into account, for example, the impact of the higher interest rates on tax-exempt housing bonds that almost certainly will result from enactment of the dividend proposal. Forty-two percent of Housing Credit apartments developed annually are financed with tax-exempt bonds.

E&Y finds that corporate Housing Credit investors—who account for 98 percent of Housing Credit equity raised annually—would either limit the amount of capital they invest in Housing Credits or lower the price they are willing to pay for them, reducing the amount of Housing Credit equity available to produce affordable rental housing.

Simply stated, Housing Credits would be worth less to corporate investors. With enactment of the dividend exclusion, the more taxes a corporation pays, the more income shareholders could receive tax-free from the corporation. Since Housing Credits reduce corporate taxes, they would also reduce the corporate profits available to shareholders tax-free. Corporations seeking to maximize shareholder benefits would find Housing Credits less attractive.

The bottom line—corporations may still invest in the Housing Credit, but they would probably invest substantially less for each dollar of Housing Credits than they do today. This price adjustment would be necessary to compensate shareholders for reducing their tax benefits.

With less Housing Credit equity available, developments would face significant financing gaps. More "soft financing," typically provided as very low-cost or deferred loans from public sources, would be needed to fill the gap, essentially replacing the lost Housing Credit equity. Otherwise, developments would be financially infeasible.

Unfortunately, soft financing has become increasingly scarce due to federal, state, and local budget constraints. Without substantially increased government funds—unlikely in today's budget environment—existing public funds would be called upon to provide more subsidy to fewer properties. The rest simply would not move forward.

Properties located in distressed low-income communities and high-rent markets are at the greatest risk. These developments qualify for more Housing Credits than other properties because Congress recognized they are especially difficult and costly to develop, but meet an essential need. These properties typically rely on Housing Credit equity to fund a larger share of their development costs. A proportional cut in equity investments would hurt these properties the most.

What's the Answer

Solutions to the threat the dividend proposal poses the Housing Credit are at hand. One remedy is to treat Housing Credits as taxes paid, much like the proposal treats the foreign credit. Other approaches may work as long as they do not negatively affect the value of the Housing Credit. We stand ready to assist the Committee in evaluating alternative approaches.

We implore the Committee to act quickly, however. Some corporate investors are already deferring Housing Credit investments pending congressional action. According to E&Y, this has destabilized the Housing Credit equity market and is likely to reduce affordable housing production in the short-term.

<u>What's at Stake</u>

America cannot afford the loss of a single affordable apartment, let alone 40,000 Housing Credit apartments annually. As of 2001, over seven million American renter families—one in five—suffer severe housing affordability problems. They spend more than half of their income on rent or live in substandard housing. Meanwhile, more than 150,000 affordable apartments are lost each year due to rent increases, abandonment, and deterioration.

In the face of this staggering need, the Housing Credit is the only significant producer of affordable rental housing. Since 1986, it has financed 1.5 million apartments for low-income Americans—working families, seniors, the homeless, and people with special needs all across the country. Each year, the Housing Credit finances 115,000 more affordable apartments.

Virtually all Housing Credit apartments are dedicated for 30 years or more at restricted rents to families with incomes of 60 percent of area median income (AMI) or less. Often, Housing Credit residents earn far less than federal income limits permit. In 1997, the GAO found the average Housing Credit resident earned 38 percent of AMI. A majority of Housing Credit properties are committed to low-income use for periods longer than 30 years, many for 50 years or more.

In my home state of Rhode Island, the Housing Credit has produced over 5,600 affordable apartments and accounts for an additional 325 apartments each year. With rents of about $500 a month, these apartments are homes to our store clerks, nurses' aides, and truck drivers.

Rhode Island's working families need the affordable apartments the Housing Credit provides now more than ever. Between 1998 and 2002, the average rent for a two-bedroom apartment in Rhode Island increased 40 percent. Income growth has not begun to keep pace.

The Housing Credit in Rhode Island, however, does so much more than provide affordable rental housing. From the renovation of former mill housing in Westerly, bordering Representative Nancy Johnson's (R-CT) home state of Connecticut, to the conversion of a former factory in Cumberland, bordering Representative Neal's home state of Massachusetts, the Housing Credit revitalizes neighborhoods. I know from my HFA colleagues that the Housing Credit is helping to rebuild communities like these all across the country.

Congress Had the Right Idea

Congress understood when it created the Housing Credit that affordable apartments would not be produced without it or some form of tax incentive or subsidy. Apartments simply cost too much to build to rent at rates affordable to low-income households.

At the time, Congress took a remarkable, bold new approach to dealing with the low-income housing shortages that afflict almost all parts of our country. Rather than create another Washington-knows-best, one-size-fits-all program, you empowered the states to determine how to respond best to their housing needs. Rather than build another top-heavy Washington program bureaucracy, you entrusted the states to administer it, with rational IRS regulation and oversight. Rather than rely on the uncertainty of federal appropriations, you harnessed the resources of the private sector to capitalize it.

Today, the Housing Credit produces high quality, privately owned affordable rental housing in the parts of the country where it is most needed. This housing is built with $6 billion in private sector capital annually through highly effective public-private partnerships.

The Housing Credit has become more and more efficient over time, due in large part to both Congress's 1993 decision to make the Housing Credit permanent and increased corporate investment. Prices investors pay for Housing Credits have risen approximately 50 percent since the program's creation in 1986, increasing the amount of private sector equity capital that goes directly into affordable housing production.

The Housing Credit is not just good for housing; it is good for the economy. Housing Credit apartments account for up to 40 percent of all apartment production annually. Each year, the construction and operation of Housing Credit properties generates approximately $8.8 billion of income for the economy, creates 167,000 jobs, and produces $1.35 billion in revenue for cash-strapped local governments. In just my small state of Rhode Island, 100 jobs would disappear, $3.4 million in wages would be lost, and $1.8 million in federal, state, and local taxes would go uncollected, if 35 percent of our annual Housing Credit production were lost.

Mr. Chairman, Congress had the right idea when it created the Housing Credit. It is the most successful federal affordable housing program ever. Protect it now from the unintended negative consequences of the dividend exclusion proposal.

Thank you for your attention. NCSHA is available to assist you in any way.