PROPOSALS OF THE AFFORDABLE HOUSING TAX CREDIT COALITION TO STIMULATE INVESTMENT IN LOW INCOME HOUSING TAX CREDIT PROPERTIES

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The Low Income Housing Tax Credit (Housing Credit) has for more than twenty years been the principal financial tool in the production and rehabilitation of rental housing affordable to lower income persons. More than two million rental units have been developed under this program since the enactment of the Housing Credit in 1986. The construction of this housing has had a significant positive impact on the economy and in job creation. Indeed, virtually all affordable rental housing developed in the Nation utilizes the equity capital raised from the Housing Credit. While there are other forms of assistance often utilized in this housing, the one constant in affordable rental development has been the Housing Credit. Approximately 70 percent of all rental housing produced involves this very successful program.

One of the results of the subprime mortgage crisis is that the need and demand for rental housing is increasing and is likely to increase further in coming years. With credit tightening, many people will not be able to find or afford home mortgages and others will simply determine that homeownership is not the right housing option for them.

The Housing Credit industry is now experiencing its own crisis, one that threatens its continued success. The major problem is attracting sufficient investor capital to finance the Housing Credit properties that have received Housing Credit awards from state housing agencies. The economic downturn has dramatically reduced investor demand for Housing Credit investments, particularly in the financial services sector, which has provided a substantial majority of the capital for this program for years. <u>The reduction is dramatic</u>**—**in 2007, approximately $9 Billion of equity was raised in the Housing Credit industry. For 2008, that amount is likely to be somewhere in the range of $4 to $5 Billion, a reduction in one year of 44% to 55%! Even worse, at this time, there is hardly any investor demand, which means that 2009 could be even more bleak than this year.

The result of this lack of equity capital is that thousands of critically needed affordable rental units will not be built or preserved and lower income families and seniors throughout the country will find it more difficult or impossible to find the decent, safe and sanitary housing produced by the Housing Credit program. Many projects which have been awarded Housing Credits will not be built due to lack of equity capital. Although it is impossible to know this number with certainty, our estimate is that hundreds of projects may not be able to move forward.

The implications of this issue affect employment creation and the economy as a whole. According to economists at the National Association of Home Builders (NAHB)[1], the

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[1] The Direct Impact of Home Building and Remodeling on the U.S. Economy, National Association of Home Builders, October 7, 2008 (authors Helen Fei Liu and Paul Emrath) @ www.HousingEconomics.com

development of a typical 100 unit multifamily apartment complex generates 116 jobs, $8,670,900 in income from all affected industries and $3,349,400 in tax revenue (including income, sales and property taxes and other assessments) to federal, state and local governments. Jobs are created in the construction trades and in companies that supply goods and services integral to the development of this housing such as lumber, concrete, lighting fixtures, doors and windows, roofing materials, heating and air conditioning equipment as well as financial services firms, property management companies and other professional service companies.

After twenty years of continued success in the capital markets, why is the industry now unable to raise the needed funds? As noted above, the general economic climate and the unavailability of capital are the major culprits. But other factors have played an important role—Fannie Mae and Freddie Mac together had combined for 30% to 40% of the investor capital over the past several years and for obvious reasons, they are no longer making new investments. In fact, there continues to be widespread concern that the GSE's could begin to sell some of their existing portfolios at discount prices, which would interfere with raising investment capital for new properties. Most of the remaining investment dollars has come from banks and other financial institutions, which are experiencing their own credit and liquidity problems.

The proposed solutions, outlined below, are intended to stimulate new investment from corporate investors which have participated in the program, but whose interest in the Housing Credit has waned, and from new companies which have not previously invested. The key to stimulating new investment is to make the returns to investors more attractive. In the past several years, demand for Housing Credit investments drove yields to investors to historically low levels and many investors simply found the investment financially unattractive and stopped investing. The remaining investors have, as noted above, been severely impacted by the credit crisis and have either reduced substantially or eliminated their investments in this program. However, we are confident that these investors would be highly motivated to begin investing again if the returns were substantially more attractive.

We very much appreciate that the Congress passed legislation in July of this year (the Housing and Economic Recovery Act of 2008 or "HERA") which contained some important and helpful provisions pertaining to the Housing Credit program. One of these provisions allows the Housing Credit to be used to offset Alternative Minimum Tax (AMT) liability. We believe that over time these provisions, including AMT relief, will prove to be very useful but the improvements contained in HERA, standing alone, are not sufficient to stimulate the investment needed now to produce this housing.

Coalition Proposals

1) On a temporary basis, the credit period should be reduced from ten to five years.

Under Section 42 of the Internal Revenue Code of 1986, as amended (the Code), the period over which the Housing Credit is received, known as the "credit period", is ten years. One problem with the length of the credit period is that many companies cannot with confidence predict their tax liability over that period of time and they have therefore declined to invest; the current economic uncertainty has served to make this problem even worse. A second problem is that the ten year period reduces the value, or yield, to the investor because of the time value of money.

This reduction in the credit period would be temporary and would be effective for Housing Credit allocations made in 2008, 2009, 2010 and 2011. For allocations made in 2008, the shortened credit period would apply only where a binding contract to invest had not been entered into by the taxpayer first claiming the Housing Credit for a particular building on or before October 3, 2008. (We suggested this date because it coincides with the enactment of the Emergency Economic Stabilization Act of 2008, but our major concern is that the binding contract cut-off date not be in the future as this would serve to freeze any current investment decisions until this legislation is enacted). There would also need to be an adjustment to the annual applicable percentage so that it would continue to yield a present value credit of 70% for non-federally subsidized new construction and substantial rehabilitation buildings and 30% for buildings which are financed by tax-exempt bonds and existing buildings.

We believe strongly that this proposal would attract substantial new capital to this program by raising yields to investors and that companies who had previously not invested because of concerns about their ability to predict tax liability over ten years would be much more interested in investing. In our view, this proposal would stimulate immediate new investment in Housing Credit properties and this capital would be quickly available for properties that have been stalled due to lack of Housing Credit equity, but are otherwise ready to start construction. The economic stimulus from this proposal would be felt quickly.

2) <u>Taxpayers should be permitted to carryback the Housing Credit for up to five years and these Housing Credits should be used to offset AMT liability during that period.</u>

Under Section 39 of the Code, most business credits, including the Housing Credit, may be carried back for one year and carried forward for 20 years. There is an exception for the marginal oil and gas well production credit, which may be carried back for five years. Until 1997, with the passage of the Taxpayer Relief Act of 1997, the Code permitted a three year carryback of business credits.

A lengthened carryback rule would produce two positive results for the Housing Credit industry that we believe would contribute to increased investment activity. First, investors would know that if their tax liability were to decrease and they were unable to use future year credits, they could be used in any of five prior tax years. This would make the program much more attractive, particularly for companies who are currently profitable but are uncertain about their tax liability in coming years.

Second, companies without current tax liability may be tempted to sell their existing portfolios, perhaps at substantially discounted prices. As a result, other investors, sensing the opportunity to purchase these credits at very attractive prices, have declined to make new investments and that situation has further exacerbated the already depressed market. Although the Federal Housing Finance Agency, which oversees Fannie Mae and Freddie Mac, has stated publicly that the GSEs will not make "wholesale" dispositions of their portfolios, even a partial sale of their very substantial holdings would interfere with raising new capital for new properties. A five year carryback for these companies and others without current tax liability would encourage such taxpayers to use their credits in prior years when they had tax liability; presumably, they would choose to use credits where they would receive a dollar-for-dollar return from Treasury rather than sell their credits for something far less.

As noted above, HERA permits Housing Credits to be used against AMT liability, effective for properties placed in service after 2007. We would ask that the revised carryback rule permit these Housing Credits to be used in the prior five year period. In addition, we propose that Housing Credits arising from properties placed in service before 2008 also be allowed against AMT liability during this period. It is our understanding that for some major Housing Credit investors, a lengthened carryback that is not coupled with AMT relief would not be helpful in that these companies were subject to AMT during the prior five years.

3) <u>Housing Credit Agencies should be permitted an additional year to make Housing Credit allocations before having to return unused Housing Credits to the "national pool".</u>

Under Code Section 42(h)(3), a Housing Credit agency is permitted to carryforward its unused Housing Credit ceiling for one year. To the extent that the amount carried forward is not used in the succeeding year, the Housing Credit agency forfeits that amount to a national pool of unused Housing Credits which are re-distributed by Treasury to states which have fully used their entire Housing Credit amount in the prior year.

In light of the lack of equity capital available, as discussed above, many states may find that they are unable to allocate all of their Housing Credits in 2008 and if the lack of investment activity continues into next year, these states face the prospect of losing Housing Credits to the national pool in 2010. We believe it would be unfair to penalize agencies for circumstances beyond their control and that they should be given an additional year to use these Housing Credits before they are lost to the national pool. While this proposal is not going to stimulate new investment activity, we believe it is fair and will help states make better decisions about the projects that are to receive awards.

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We appreciate your consideration of these important proposals.

The Affordable Housing Tax Credit Coalition (the "Coalition") is a trade association comprised of developers, syndicators, lenders, nonprofit groups, public agencies, and others concerned with the development and financing of affordable rental housing through the use of the Housing Credit. Since its founding in 1988, the Coalition has worked closely with the Congress in making the Housing Credit a permanent part of the Code and in enacting legislation that has improved the program and allowed it to become the most successful federal rental housing production program in history. We are proud of the role we have played and of the reputation we have developed in educating the Congress about how this program can best serve the needs of low income persons.