Council for Affordable and Rural Housing
Serving the Affordable Housing Needs of Rural America

Addressing the Need for Affordable Housing in Rural America in the 2009 Economic Stimulus Legislation

As the nation addresses the crisis in homeowner housing, it is important to remember that we have a productive, affordable rental housing industry providing housing to the most vulnerable among us. However, the affordable rental housing industry is in jeopardy because of credit problems in the wider economy. The Council for Affordable and Rural Housing (CARH) represents the interests of builders, developers, managers and suppliers of affordable rural housing throughout the country. Affordable rental housing issues affect residents and a broad array of local government, non-profit and for-profit participants working together in partnership. The need for affordable housing persists and it cannot be adequately addressed except through current delivery mechanisms, developed and made more efficient over decades of providing affordable housing. In rural areas throughout the country, there continues to be an even more acute need for affordable and decent housing. Recent statistics suggest that rural renters are more than twice as likely to live in substandard housing as people who own their own homes. With lower median incomes and higher poverty rates than homeowners, many renters are simply unable to find decent housing that is also affordable. While the demand for rental housing in rural areas remains high, the supply, particularly of new housing, has decreased.

Rural housing is dependent on several sources of funding for construction and preservation of the existing housing stock. The first important component is the Low Income Housing Tax Credit (LIHTC) program. The second component would be programs administered by the Department of Agriculture's Rural Development (RD) Housing and Community Facilities agency. The following issues should be addressed in the economic stimulus legislation that will soon be considered by the Congress.

Low Income Housing Tax Credit

CARH appreciates that Congress passed in July and the President signed into law, the Housing and Economic Recovery Act of 2008 (HERA), helping modernize the LIHTC program. Unfortunately, economic conditions have deteriorated more than was previously thought and these new conditions require a further response. As a result, the LIHTC has become infeasible for many investors, even though the market for affordable rental housing remains strong and the vast majority of properties constructed remain successful. The situation has become even more acute in rural areas because there are a limited number of investors and even those companies are stepping away from transactions.

The proposed suggestions outlined below are aligned with those recommended by the Affordable Tax Credit Coalition and other affordable housing groups. These recommendations are intended to stimulate new investment and therefore new construction as well as rehabilitation of the rural housing portfolio throughout the country.

Recommendations:

1.) Provide temporary authority for a refundable LIHTC.

The LIHTC essentially functions as an offset against income earned for corporate investors. However, in the current unsettled economic environment there are willing corporate investors that do not have sufficient predictable future income, and with it, tax liability over the 10-year credit period to use this offset, chilling potential equity investment. The LIHTC should be refundable so that the U.S. Treasury can provide a cash refund when the taxpayer is unable to use housing credits. This change would help stimulate investment.

2.) <u>Provide a temporary grant program to make up for funding gaps.</u>

Even in today's economic environment, there are some LIHTC transactions that have been able to attract investors, but the price investors are willing to pay has dropped dramatically. Until this market trend recovers, there needs to be a grant program to provide gap financing. The Department of Housing and Urban Development's (HUD) HOME program could provide this gap financing, but additional funds above the current fiscal year will be needed. CARH would recommend $5 billion for Fiscal Year 2009, $4 billion in Fiscal Year 2010 and $3 billion for Fiscal Year 2011.

3.) <u>Permit investors to carry back LIHTC for up to five years and Alternative Minimum Tax (AMT) to also be used to offset AMT liability during this period.</u>

Under current laws LIHTC's may be carried back for one year and carried forward for 20 years. CARH believes as with the marginal oil and gas well production credit, the LIHTC should be carried back for five years. This recommended change would allow investors to know that if their tax liability decreased and thus were unable to use future years credits, credits could be used in any five prior tax years. The LIHTC program would be more attractive particularly for companies that are currently profitable but there is uncertainty about tax liability in future years.

Past investors, primarily Fannie Mae and Freddie Mac as well as other investors without current tax liability will be able to use credits for the previous five years, particularly if they had tax liability and therefore receive a dollar-for-dollar return rather than selling credits for less. Finally, the five year carry back should be accompanied by an ability by the tax payer to use those credits to offset AMT.

<u>4.) Temporarily permit LIHTC to be applied against ordinary income of individuals, without any limit.</u>

Current law permits individuals who invest in the LIHTC to apply those credits to no more than $25,000 of ordinary income multiplied by the individual's tax bracket. With a marginal rate of 35 per cent, the maximum credit would be $8750. Temporarily removing this credit would permit individuals to invest substantial sums in tax credits, which would help offset the sharp decline in corporate investment in the tax credit. For similar reasons, investment entities like Subchapter S corporations and Limited Liability Companies (LLCs) should not have any impediments to passing through LIHTC benefits to their individual investors.

<u>Department of Agriculture</u>:

<u>Section 515 Multi-Family Rural Rental Housing Program</u> –

The Section 515 Multi-Family Rural Rental Housing Program administered by RD's Housing and Community Facilities is one of the few resources that enables the very low-income and low-income renters in rural America to access decent, safe and affordable housing. The Section 515 program also reduces homelessness and overcrowding. The demographics of the residents in these complexes are as follows: the average annual tenant income is $10,500; 72% of the households in the complexes are headed by women; 41% are headed by an elderly person; and 26% of the households are headed by a minority.

Approximately 70,000 residents pay more than 30% of their income toward rent, and 25,000 pay more than 50%, yet these families remain in RD housing. Although they are heavily rent-burdened, these families see RD housing as their best alternative. In many of America's rural communities, there have not been other safe and sanitary alternatives for very low-income residents.

Since the program's inception, in 1963, over 526,187 affordable rental housing units in 27,505 apartment complexes across the country have been selected for funding. This represents an investment, in affordable rental housing for rural America of $14,961,124,085. The current outstanding portfolio, as of February 2007, is in excess of $11.3 billion dollars with 15,720 apartment complexes that contain 443,000 affordable rental housing units. The typical new property consists of 24 units with an agency per-unit cost of $37,000 for a total loan of approximately $900,000. There are additional leveraging partners to provide the additional funds to develop the property.

Recommendations:

1.) An additional $400 million should be allocated to the Section 515 program.

CARH recommends that $400 million should be allocated to the program in the economic stimulus package. Funding would go for preservation of existing complexes and construction of new complexes in many areas of the country where there is a severe shortage of affordable housing. In addition to housing more low-income rural Americans, additional funding would help create throughout the country 51,000 construction related jobs such as carpenters, roofers, painters, and plumbers.

2.) Preservation Tax Incentives are needed in order to help in the preservation of the existing Section 515 portfolio.

The success of the Section 515 program has been a direct result of the involvement and funding in part by the private sector. However, rents have traditionally been very low and as a result anticipated owner returns never materialized. At the same time, changes in tax law and the creation of statutory prepayment barriers have made recapitalization even more difficult. Current stock of this housing is at considerable risk because of the interplay between the design of the program and the depreciation recapture rules. A modest change in the tax code should be adopted to preserve the stock of Section 515 affordable housing at minimal revenue cost to the federal government. This could be accomplished by waiving the depreciation recapture tax liability, when investors sell their property to new owners who then agree to invest new capital in the property and to preserve the property as affordable housing for another 30 years.

Section 521 Rental Assistance Program

The Section 521 Rental Assistance (RA) Program is an important component of the Section 515 program in that it provides an additional deep subsidy to very low-income residents by providing the difference between 30% of a resident's income and the basic rent required to operate the property ("basic" rent is that which is required to cover general operating expenses, pay the mortgage on a 1% interest rate note, and provide an 8% return on the owner's equity, which is currently 3% or 5% of the project cost). Some Section 515 projects also utilize the Department of Housing and Urban Development's (HUD) Section 8 Rental Assistance, which then enables additional very low-income families to be served.

Recommendations:

1.) An additional $500 million should be allocated for the Section 521 program.

CARH recommends that an additional $500 million be allocated for the Section 521 program. This increase will ensure that all income eligible residents would receive rental assistance while at the same time allow owners to increase rents in order to make needed capital improvement at existing complexes; enabling residents to pay no more than 30% of their income for rent. New construction would also have the necessary RA to make projects feasible. Current budget constraints have not permitted RA in new construction. In addition, additional RA would make rural transactions more attractive to investors of LIHTC, an integral component of the rural portfolio.

2.) Rental Assistance contracts should be for 20 years, subject to annual appropriations.

Rental Assistance contracts funded through the Section 521 program should be treated the same as HUD's Section 8 contracts. Rather than being renewed annually, they should be 20-year contracts subject to annual appropriations. This change would increase lender confidence and make rural transactions more attractive to investors of LIHTCs.

<u>Section 538 Rural Rental Housing Guaranteed Loan Program</u> –

The Section 538 Rural Rental Housing Guaranteed Loan program authorizes guarantees of privately made loans for the development of new multifamily housing for low and moderate-income persons and shows great promise in providing financing to serve persons in rural areas at very little cost to the federal government. Any cost involved comes from the statutory requirement that at least 20% of the loans be given a thin subsidy to lower the interest rate to the applicable federal rate. The rate is based on the 30-year Treasury bond rate on the day of closing. The guarantee program is intended to operate, in many situations, in conjunction with other assistance programs, such as HOME, LIHTC and tax-exempt bonds.

<u>Recommendations:</u>

<u>1.) The Section 538 program should be allocated an additional $50 million.</u>

The Section 538 program can quickly create jobs and place housing into production projects otherwise on hold. The guarantee is administered by RD but the loan processing and servicing is largely performed by the private lenders applying for the guarantee. This uses an existing delivery mechanism. This additional $50 million in appropriations would guarantee $500 million in loan guarantees. CARH also recommends interest credit subsidy for these loans that will be sufficient to reduce the effective interest rate to 1 percent. This would substantially reduce operating expenses for these properties, closing gaps experienced from a lack of low income housing tax credit funding, or because credits are effectively no longer available in certain rural areas. The Section 538 program does not replace Section 515 funding because guarantees of the Section 538 program support transactions for low- income persons, where as the Section 515 program is a lower cost direct loan, which supports extremely low- income persons. Additional funding for the Section 538 program would also create 60,000 construction related jobs such as carpenters, electricians, painters, plumbers and roofers.

<u>2.) Ginnie Mae should be directed to accept Section 538 new construction loans.</u>

Ginnie Mae should also be directed to accept Section 538 new construction loans where the loan to value limits are consistent with program requirements. This would allow 90% loans to go to for-profit borrowers and 97% loans for non-profit borrowers rather than the current limitation of 50% Section 538 loan to value.

<u>3.) Increase the ceiling limitation on interest credit assistance.</u>

Increase the ceiling limitation on interest credit assistance on 538 loans from $1,500,000 to $3,000,000. ($1,500,000 times 2.5% equals $37,500 in subsidy to $75,000 for $3,000,000 538 loans.) This change could also help with gap financing for Section 538 transactions that also received a LIHTC allocation and where the credit has decreased in value. It could also mean that some projects that do not get LIHTC could cash flow using only Section 538 subsidized debts. This would be a small impact in the program subsidy rate and would immediately make many projects affordable and feasible that are now not going to close because of the reduction in the price of LIHTC.