NASLEF

The National Association of State and Local Equity Funds

April 14, 2015

Comments to the Senate Finance Committee Infrastructure and Community Development Tax Reform Working Group on the Low-Income Housing Tax Credit

These comments are being submitted on behalf of the National Association of State and Local Equity Funds ("NASLEF"), an organization comprised of nonprofit organizations that raise equity capital for investment in Low-Income Housing Tax Credit ("Housing Credit") properties. Our 14 members operate in 40 states and have raised almost $12 billion in equity capital to finance the production or rehabilitations of about 150,000 units of affordable rental housing.

NASLEF is an organization of nonprofit entities that were in most cases formed under the sponsorship of state housing finance agencies who wanted to make sure that there was an adequate source of equity capital to finance Housing Credit development within their state. The Housing Credit capital markets have changed considerably since that time but our organizations remain competitive sources of financing that work closely with nonprofit developers in our states to finance the most difficult to develop affordable housing properties. We continue to work closely with state housing finance agencies and play a leadership role in the affordable housing communities in our states. Those include several states represented by members of the Senate Finance Committee.

Our basic message to the Infrastructure and Community Development Working Group is that the Housing Credit must be preserved and even enhanced as part of any tax reform legislation the Senate Finance Committee considers.

BACKGROUND ON AFFORDABLE HOUSING NEEDS

The United States faces greater challenges than ever in attempting to provide quality, affordable housing to its citizens. One in four renters in the U.S. today pays more than half their income in rent. For lower income families access to affordable housing presents even greater challenges. Nearly one-quarter of all renters in the United States have income at or below 30% of the area median income, and three-quarters of these extremely low income renters are forced to spend more than half of their income on the cost of rent and utilities due to the ongoing shortage of affordable housing. In fact, there are just 31 affordable and available rental units for every 100 extremely low income renter households.

The affordable housing crisis is getting worse each year as incomes at the bottom of the income scale have stagnated while the shortage of housing has led to higher rents. The number of households experiencing “worst-case housing needs” -- more than 50% of income paid for rent and/or living in severely inadequate housing -- has risen 9% just since 2009 and 49% since 2003.

Consider for a moment the lives behind these statistics. We like to think of America as a nation that offers great opportunities to all of its citizens, where the prospect for a better life ahead is there if we just apply ourselves. But the expenditure of such a large share of family income on rent and utilities displaces other basic family needs for such basics as food, health care, education, and transportation. This lends itself to family instability that can undermine educational achievement and employment potential. Members of Congress across the political spectrum share an abiding belief that all Americans should have the opportunity to succeed. Yet many Members do not fully appreciate how the affordable housing crisis relates to economic opportunity. One indication of that is the continual decline in federal appropriations devoted to affordable housing.

The Housing Credit has been an exception to that general decline in housing assistance since it is a “permanent” part of the Tax Code. But in spite of the great success of the program, it now also faces threats, in this case from tax reform. Even if the allocated Housing Credit is preserved, tax reform poses a threat to the program from other potential changes to the Tax Code such as longer depreciation for residential housing, lower tax rates for corporations, and elimination of the multifamily bond program.

HOUSING CREDIT CHALLENGES AND THE NEED FOR MORE RESOURCES

Since it was created as part of the Tax Reform Act of 1986, the Housing Credit has helped to serve the needs of the lowest income households, creating more than 2.6 million affordable apartments. The program finances a little less than 100,000 affordable homes each year but that barely keeps up with the number of units lost annually to abandonment and conversion to market rate housing. The demands on the program are overwhelming. Today, in almost every state, demand for the credit exceeds supply by a factor of at least two to one and more typically three to one. The program has been an excellent tool for states to help manage their affordable housing needs, whether for housing that serves families, the elderly, or special needs populations; located in rural areas, cities or the suburbs.

But because the program has achieved such great success in a variety of settings as a flexible tool to help state and local governments address their affordable housing needs, the intense demands on the program present serious resource challenges. For example, an increasing share of Housing Credit resources are going to help finance the preservation of existing federally assisted housing, both properties that need capital for property rehabilitation and properties that are at high risk of being converted to market rate housing. In addition, the Housing Credit is increasingly being used as a means of recapitalizing public housing properties that are in disrepair because of many years of neglect from the federal government.

When so much of this limited resource must be devoted to just maintaining existing housing, that leaves fewer resources for development of new properties to help address the shortage of affordable housing. This is why the Housing Commission of the Bipartisan Policy Center recently endorsed a 50% increase in the amount of Housing Credits available to each state. The Housing Commission was a bipartisan assembly of leaders in housing policy that included two former HUD Secretaries, three former Senators, and the leaders of several policy organizations focused on housing finance. They undertook an intense study of the nation's housing needs, reviewed what works and what doesn't, and unanimously endorsed the Housing Credit program. In its report, the Housing Commission noted that the federal government spends large sums each year on housing, the bulk of it in the form of tax subsidies for single family housing. While calling for more resources for affordable housing, the Commission called for a rebalancing of federal expenditures on housing to focus more on helping the most vulnerable populations.

Conversion of Private Activity Bond Cap to Housing Credit Authority

NASLEF fully supports this proposal from the Bipartisan Policy Center and urges the Community Development Working Group to propose an increase in state Housing Credit allocation authority. *One lower-cost means of achieving this result that we strongly urge you to consider is to permit states to convert a portion of their private activity bond cap authority to Housing Credit authority.* This can be designed in many ways but the key point is to give states greater flexibility to manage their federal resources according to the specific needs within the state.

THE NEED TO PRESERVE EXISTING HOUSING CREDIT RESOURCES

The basic concept of the Housing Credit is that it enables affordable housing properties to be developed with equity capital as a substitute for debt capital. Debt must be smaller portion of the financing mix in affordable properties because rental income – which is applied to cover the debt costs – is much lower.

Any changes in the tax laws which reduce the amount of tax benefits in a Housing Credit property also decrease the amount of equity capital that can be raised. This fundamental relationship should be understood by policymakers accessing the future of the Housing Credit program.

As a developer puts together financing to build an affordable housing property, it first must determine the level of debt that the property can support, then the level of equity that can be raised from the Housing Credit. In almost all cases, these two sources of financing are not sufficient so gap financing must be arranged, typically in the form of a soft loan that carries a low interest rate with liberal repayment terms. If the equity portion of this financing is reduced because of a cutback in the tax benefits associated with a Housing Credit property, the developer must either increase the size of the debt or find more gap financing.

Minimum Credit Rates. NASLEF members working today with nonprofit affordable housing developers to help finance Housing Credit developments face serious challenges to secure sufficient financing. First, sources of gap financing are more difficult to find due to cut backs in spending at the local, state and federal level. The largest source of gap financing is the HOME Investment Partnership program which has seen its funding cut by more than 40% in recent years. Second, the expiration of the minimum 9% credit rate has reduced the amount of equity that is contributed to a Housing Credit development. The credit rate on Housing Credit investments is tied to the federal government's cost of borrowing and historically low interest rates have reduced Housing Credit rates. The minimum 9% credit rate is one of more than five dozen expiring tax provisions and was treated the same as the other provisions when they were retroactively extended last year. But the retroactive extension of the minimum 9% credit rate has no effect on state credit allocations already made so the Housing Credit program has had to operate with about 17% less equity capital going into each development. Fortunately, credit pricing is very strong currently and that can compensate to a certain extent for the reduced credit rate and shortage of gap financing. But the challenge we face is developing this housing so that it is affordable to the most vulnerable populations further down the income scale. The unfortunate solution to less Housing Credit equity is for properties to target residents higher up the income scale so that rents can be raised to support more debt on the property to offset the reduced equity.

To address this problem, Congress should permanently establish minimum credit rates at 9% for new construction and substantial rehabilitation and at 4% for acquisitions and for tax exempt multifamily bond deals. Legislation to permanently establish a 9% and 4% credit rate for acquisitions has received strong bipartisan support but this issue has unfortunately been caught up in the failure of Congress to extend the expiring tax provisions on a timely basis.

Depreciation of Residential Real Estate and Lower Corporate Tax Rates. About 30% of the tax benefits associated with a Housing Credit property are generated by losses on the investment. The rate of depreciation on residential real estate, as well as the corporate tax rate at which the losses can be taken, have an important effect on the value of such losses.

We understand the fundamental trade-off involve with tax reform: base broadening in return for lower corporate rates. And we are aware that lower corporate rates will be financed in part by lengthening depreciation periods. Today, the recovery period for nonresidential real estate is 39 years while the depreciation period for residential real estate is 27.5 years. The most common proposal on the table for tax reform is to lengthen the recovery period for all real estate to 40 years. This would modestly impact nonresidential real estate while significantly increasing the tax rate on residential real estate. *We strongly urge you not to lengthen the recovery period on affordable rental housing.* Certainly, families in need of affordable housing would not directly benefit from a lower corporate tax rate so we don't believe they should be made to help finance such cuts.

We recognize the prime objective of tax reform is to lower the corporate tax rate to a level that is more competitive with our major trading partners. We do not suggest that you abandon that pursuit even though it would undermine the ability to finance affordable housing using the Housing Credit. Nevertheless, we believe it is important for you to understand that the combination of a 40 year recovery period for depreciation of affordable housing property, together with a 25% corporate tax rate, will reduce the amount of equity that goes into a Housing Credit property by roughly 7%. Those changes, in combination with the failure to restore the minimum credit rate in today's interest rate environment, would result in a cumulative reduction in equity of almost 25%. That will make it even more difficult to develop affordable housing especially for the most vulnerable households with lower incomes.

MULITFAMILY HOUSING BONDS

About forty percent of all affordable housing production using the Housing Credit is financed with tax-exempt multifamily housing bonds. These developments utilize tax-exempt financing in conjunction with the 4% Housing Credit to build affordable housing. The Tax Reform Act of 2014, developed by former Ways and Means chairman Dave Camp, proposed to eliminate the multifamily bond program along with all other private activity bonds. *Since multifamily housing bonds are such an important contributor to overall affordable housing production, we strongly urge you to preserve this program in tax reform.* We recognize that some types of private activity bonds have been criticized for conferring a public benefit on private parties; we don't believe that concern applies to multifamily housing bonds. This is an important means of financing affordable housing, the development of which would not occur without such financing.

The members of NASLEF are proud of the role the Housing Credit has played over the years in providing affordable housing to American families. The program has an excellent record and has been able to build strong bipartisan support in Congress and among elected officials across the country. Very simply, the program works. We hope as you work on tax reform legislation that you will recognize the importance of the Housing Credit and work with the affordable housing community to figure out a means of preserving and enhancing this valuable program.

Thank you for your consideration and please let me know how our members can effectively inform this discussion.

Nancy Owens

President, Housing Vermont
President, National Association of State and Local Equity Funds

NASLEF MEMBERS

CAHEC
Delaware Community Investment Corporation
FAHE Capital Corporation
Great Lakes Capital Fund
Hawaii Housing Finance, LLC
Housing Vermont
Massachusetts Housing Investment Corporation
Merritt Community Capital Corporation
Midwest Housing Equity Group, Inc.
Mountain Plains Equity Group, Inc.
Northern New England Housing Investment Fund
Ohio Capital Corporation for Housing
St. Louis Equity Fund
Virginia Community Development Corporation