NOVOGRADAC & COMPANY LLP
CERTIFIED PUBLIC ACCOUNTANTS

April 15, 2015

Committee on Finance
Community Development & Infrastructure Tax Reform Working Group
219 Senate Dirksen Office Building
Washington, D.C. 20510

Dear Co-Chairman Heller, Co Chairman Bennet, and Members of the Working Group:

The LIHTC Working Group was established to provide a platform for the low-income housing tax credit (LIHTC) community to work together to resolve technical and administrative LIHTC program issues. On behalf of the members of the LIHTC Working Group, we respectfully submit comments why the LIHTC should be retained as comprehensive tax reform is being considered. The members of the LIHTC Working Group strive to make the LIHTC even more efficient in delivering benefits to help build affordable rental housing. Our group includes nonprofit and for-profit developers, property managers, lenders, syndicators, investors, accountants and lawyers. We hope to engage the Community Development & Infrastructure Tax Reform Working Group in a continuing dialogue on the benefits of the LIHTC, as well as the importance of retaining the LIHTC as a permanent part of the tax code.

The LIHTC was established as part of the Tax Reform Act of 1986, and is codified in Section 42 of the Internal Revenue Code (IRC). Since its creation, it has financed virtually all affordable rental housing in the U.S., creating or preserving more than 2.7 million affordable rental homes, according to the National Council of State Housing Agencies. It has achieved this by leveraging more than $100 billion in private capital. The LIHTC is the leading example of pay-for-performance public-private partnerships. Its structure as a tax expenditure that can only be claimed after promised outcomes have been achieved ensures a high degree of efficiency and accountability, which is why the LIHTC has always experienced bipartisan support. In a typical year, the program supports roughly 96,000 jobs, mostly in the small business sector, and provides approximately $9.1 billion in local economic income and $3.5 billion in federal, state, and local taxes paid, according to the National Association of Home Builders[1].

In light of record of achievement, we recommend that the working group:

- Retain the LIHTC and multifamily housing private activity bonds in a reformed tax code;
- Expand LIHTC resources to address the nation's growing affordable housing needs; and
- Make improvements to provide for even greater efficiency of existing LIHTC resources.

[1] The Economic Impact of the Affordable Housing Credit," National Association of Home Builders, 15 July 2014, http://eyeonhousing.org/2014/07/the-economic-impact-of-the-affordable-housing-credit/

<u>Retain LIHTC and Multifamily Housing Private Activity Bonds in a Reformed Tax Code</u>

The LIHTC is one of the most important and successful federal housing programs ever created, and it is responsible for helping build, renovate and/or preserve approximately 90,000-100,000 more affordable rental homes each year. About 40 percent of these homes are financed by LIHTC that is generated by multifamily housing private activity bonds, underscoring the importance of private activity bonds to the LIHTC's annual affordable rental housing production. Nearly half (19 million) of the nation's renters are rent burdened and need affordable options.[2] Without the LIHTC, there would be a significant reduction in the options for these renters.

The LIHTC encourages investors nationwide to invest in affordable rental housing. Without the LIHTC, developing affordable rental housing at restricted rents for low-income families is fundamentally uneconomic, as developers would not be able to sustain the debt coverage that would be required without tax credit investor equity.

In addition to the need to preserve the LIHTC generally, it is important to protect the fundamental components of the LIHTC and not impose new limitations on eligible activities. There are two types of LIHTCs: the 70 percent present value credit (referred to as the "9 percent credit") for new construction and substantial rehabilitation of properties that are not financed with the proceeds of multifamily housing private activity bonds, and the 30 percent present value credit (referred to as the "4 percent credit") for the acquisition of existing properties and for newly constructed or substantially rehabilitated properties which receive private activity bond financing (thus making them "federally subsidized" for purposes of the LIHTC). While there is a clear need to build new affordable rental homes, acquisition and rehabilitation of existing properties to preserve affordable housing is a crucial use of the LIHTC, including preventing existing federally assisted housing from being lost to obsolescence or decay or converted to market rate housing.

The LIHTC is an efficient program with a successful track record.

The LIHTC has experienced significantly lower foreclosure rates relative to other real estate asset classes, observed lower levels of noncompliance with program requirements and maintained affordable rental housing stock over the long-term. The LIHTC's successful past performance can be attributed to the involvement of third-party for-profit partners who partner with developers and/or syndicators. The synergies of these partnerships provide benefits to LIHTC developments through economies of scale and uniform practices. The various parties involved with LIHTC investments have become very sophisticated and have streamlined their processes making the program highly efficient. The LIHTC's successful track record can also be attributed to all of the involved parties' constant monitoring of their LIHTC properties to ensure the delivery of the LIHTC benefits over a period of time, rigorous screening of the developments, construction and lease-up risk borne by the sponsors and investors instead of the federal government, and state and federal oversight of the program. This public-private partnership brings together the strengths of each partner to generate a stable investment opportunity for its investors and contributes to the successful track record of the LIHTC. Other government supported supply-side housing programs have demonstrated less consistent performance, because of issues inherent to those programs—most notably: a lack of continued property monitoring, no effective noncompliance remedy, and upfront funding of the applicable public subsidy.[3]

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[2] "America's Rental Housing: Evolving Markets and Needs," Joint Center on Housing Studies, Harvard University, December 2013

[3] "Low-Income Housing Tax Credit: Assessment of Program Performance & Comparison to Other Federal Affordable Housing Rental Housing Subsidies," Novogradac & Company LLP, 2011

The LIHTC is an acquired tax benefit, unlike most other corporate tax expenditures.[4]

The LIHTC is a credit which is essentially acquired by the investors with the low-income tenants as the true beneficiary. Investors assume the development and operating risk that is associated with the LIHTC. Investors only get to claim and keep the tax credit if affordable housing units are built, leased, and maintained as affordable throughout the 15-year compliance period. The LIHTC has been categorized as a corporate tax expenditure due to the economic efficiencies of marketing LIHTC investments to large corporations. The LIHTC should be viewed distinctly from other corporate tax expenditures as it is an acquired investor based tax credit, as opposed to a tax credit for internal operations. Also, any discussion about tax expenditures should include a distinction between those tax expenditures where the substantial portion of the benefit is retained by the recipient of the subsidy versus those where the predominant benefit of the subsidy is being low-income families. A repeal or reduction of the LIHTC would have a dramatic impact on low-income families for reasons previously mentioned, but only a minor economic impact to large corporate investors.

Retain the value of the LIHTC by maintaining 27.5 year residential rental real estate depreciation and compensating for lower corporate tax rate.

Today, approximately 30 percent of the value of a LIHTC investment is based on the tax deductions from the investment, largely arising from depreciation. For LIHTC developments financed using private activity bonds, the tax deductions are an even more important component of the investment. Though the rate of return on LIHTC investments is dictated by market conditions, extending the depreciation period would cause the tax benefits associated with an investment in LIHTC property to decline, and would drive down the amount of equity investors would contribute to a property.

The LIHTC raises more than $10 billion per year in capital from investors. According to a 2013 report, Novogradac & Company LLP estimates that lengthening the depreciation period to 43 years, as proposed by former Senate Finance Committee Chairman Max Baucus, coupled with reduced corporate tax rates to 25 percent, would reduce LIHTC investment by as much as $1 billion (roughly 10 percent) annually. This reduction in investment could result in a loss of nearly 10,000 affordable apartments and 9,500 jobs each year.[5]

It should also be noted that while most corporations benefit from reduced corporate tax rates, thereby being compensated for the loss of tax benefits through extended depreciation, the financing for LIHTC properties is harmed by both reduced corporate tax rates and extended depreciation.

Expand LIHTC Resources to Address the Nation's Growing Affordable Housing Needs

Though the LIHTC has provided affordable homes for millions of low-income households, the current levels of resources are not able to address the growing need for affordable rental housing.

An unprecedented 11 million renter households—more than one in four of all U.S. renters of all incomes—spend more than half of their monthly income on rent, according to the Harvard University's Joint Center for Housing Studies (JCHS). This burden leaves too little for necessary expenses like food, medical expenses, transportation, and education. The affordable housing crisis is especially acute among those with the lowest incomes. According to JCHS, in 2012 there were 11.5 million households with incomes at or below 30 percent of area median income (AMI), but only 3.3 million homes that were both available and affordable to them. This has created an affordable housing supply gap of 8.2 million homes

[4] Novogradac, Michael. "LIHTC: Breaking the Corporate Tax Expenditure Shackle." *Notes from Novogradac*. Novogradac & Company LLP, 18 May 2011. Web. 02 April 2013. <http://novogradac.wordpress.com/2011/05/18/lihtc-breaking-the-corporate-tax-expenditure-shackle/>

[5] "Affordable Rental Housing After Tax Reform," Novogradac & Company LLP, 2013

just for the lowest income households, marking a 55 percent increase in this gap since 2000.[6] The number of low-income households experiencing "worst-case housing needs," where such households are paying more than 50 percent of their monthly income on rent and/or living in severely inadequate housing, has increased by 9 percent since 2009 and 49 percent since 2003.[7]

The affordable rental housing crisis is expected to worsen in the coming years. Analysts expect an average of more than 400,000 new renter households to enter the market each year for the next decade[8], many of which will be low-income. At the current level of resources, the affordable housing community develops fewer than 100,000 new rental homes each year, meaning the gap in affordable housing supply will continue to grow. Meanwhile, we continue to lose affordable housing each year. Nearly 13 percent of the nation's supply of affordable housing – roughly 650,000 homes – has been permanently lost from the stock of available housing since 2001 due to conversion to market rate rentals or condominiums, demolition or obsolescence. The net effect is that, according to JCHS, "the number of affordable units has stagnated over the past decade."

The LIHTC is essentially the only way to increase the supply of affordable rental housing to meet our nation's vast unmet and growing need, and we urge the working group to consider an increase in LIHTC resources.

Make Improvements to Provide for Greater Efficiency of Existing LIHTC Resources

While the LIHTC has a stellar performance record and, based on this record, deserves to receive more resources to address the nation's unmet affordable housing needs, it could be improved to be even more efficient. The following proposals would provide greater efficiency and flexibility to address the variety of the nation's affordable housing needs:

1. **Enact permanent minimum LIHTC rates**

   Congress established in the Housing and Economic Recovery Act of 2008 (HERA), and subsequently extended twice, a minimum 9 percent LIHTC rate for new construction and substantial rehabilitation. This minimum rate allowed 15-20 percent more private equity to go into any one development and enabling such developments to target lower income families or provided needed services. The proposal would make this provision permanent, as well as simplify allocating agency administration and development planning, but would not increase overall LIHTC authority or materially increase federal costs. A similar minimum for 4 percent LIHTC used to finance the acquisition of existing property and LIHTC generated by private activity bonds should also be enacted.

2. **Promote income mixing**

   This proposal would create a third income qualification election option of reserving at least 40 percent of units at an ***average*** of 60 percent of AMI, with a maximum of 80 percent AMI on initial income certification. The average would be determined over the entire property, not a building-by-building basis. This revision would be helpful in 1) high housing cost areas, where rents of residents earning 60-80 percent AMI cross-subsidize rents of residents earning below 40 percent AMI, 2) low-income neighborhood revitalization, and 3) rural areas where sparse populations and very low AMIs make it difficult to finance properties or maintain an appropriate income mix.

[6] "America's Rental Housing: Evolving Markets and Needs," Joint Center on Housing Studies, Harvard University, December 2013
[7] "Worst Case Housing Needs: 2015 Report to Congress," U.S. Department of Housing & Urban Development, February 2015
[8] "The State of the Nation's Housing," Joint Center on Housing Studies, Harvard University, June 2014

3. **Eliminate federal taxation of state LIHTCs**

   Seventeen states currently have state LIHTCs, which are often used to help close financing gaps in LIHTC developments. In 2013, agencies allocated more than $240 million in state LIHTC, which in turn helped finance more than 10,000 affordable rental homes. However, because they are subject to federal taxation, the equity price of state LIHTC is much less than federal LIHTC, which is not subject to taxation. This proposal would increase equity price of state LIHTC, generating more LIHTC equity for affordable rental housing production.

4. **Clarify the ability to claim LIHTCs after casualty losses**

   After a casualty loss outside of federally declared disaster areas, if a LIHTC property is not fully restored and rented to qualified low-income tenants within the end of same taxable year, then there is no recapture and no loss of LIHTC. However, if the LIHTC property is not restored by the end of the taxable year, no credit would be allowed for the entire taxable year, even if the reasonable restoration period established by the Treasury Secretary, not to exceed 24 months extends into the next taxable year. This proposal would allow LIHTC to be claimed as long as units are restored within the reasonable restoration period. It would also help prevent LIHTC properties suffering casualty losses from going into foreclosure and putting its tenants at risk of losing their homes.

5. **Eliminate 10 percent test (but keep placed in service deadline)**

   LIHTC developments generally take two years from when the development was awarded the LIHTC allocation to when the property is placed in service, and typically developments with allocation awards receive a "carryover" allocation from one tax year to the next. To qualify for a carryover allocation, a development must incur 10 percent of its reasonably expected qualified basis 12 months after receiving the award and place the property in service by the end of the following year. In practice, most developments are able to meet this test. However, in some circumstances, the developments are forced to spend money just to qualify for the carryover allocation that does not advance the development process in a meaningful way. Requiring the 10 percent test adds unnecessarily to compliance costs for developments and allocating agencies.

6. **Qualify "over-income" tenants in preservation transactions if they were income-qualified at move-in**

   As noted earlier, the LIHTC is a crucial financing source for preserving existing affordable rental housing at risk of being lost to obsolescence or decay, or converted to market-rate housing. under this proposal, tenants in existing buildings whose incomes have risen over time to more than 60 percent of AMI could be counted as at or below 60 percent for LIHTC income qualification purposes as long as they were income-qualified at move-in, which would assist the financing of preservation projects. It would also help maintain a healthy mix of low-income tenants, rather than leading to the loss of renters with incomes slightly above eligibility, but still low-income.

7. **Allow qualified income for rural bond projects to be based on the greater of AMI or national nonmetro income**

   Under HERA, LIHTC developments designated as rural under U.S. Department of Agriculture (USDA) Rural Development guidelines are allowed to use the greater of AMI or national nonmetro income in 9 percent LIHTC developments. This proposal would extend that LIHTC income qualification standard for bond-financed developments, which would be helpful for bond-financed developments in rural areas where AMIs are unusually low.

8. **Clarify nonprofits right of first refusal or provide purchase option**

   Under IRC Section 42(i)(7), nonprofit sponsors have a "right of first refusal," giving them the ability to purchase a LIHTC property at the end of the 15-year compliance period at fair market value or a price equivalent to its indebtedness, exit taxes, and $1.00. This ability is triggered by a "bona fide third party offer." What constitutes such an offer is sometimes contested, and disputes as to what the fair market value is sometimes complicates exercising this ability. This proposal would clarify the circumstances to facilitate the right of first refusal. Alternatively, Congress could create a defined purchase option for nonprofit sponsors at the end of compliance period. In both cases, the proposal would help maintain the finances of LIHTC properties beyond the 15-year compliance period.

9. **Narrow student rule**

In general, LIHTCs cannot be used to finance student housing, even if students technically qualify for income purposes. In recent history, Congress has enacted some limited exceptions to this rule, such as enabling single parents and youth aging out of foster care to access LIHTC housing. Bills have been introduced to narrow the student rule further to allow veterans and homeless youth to live in LIHTC housing. Instead of enacting limited exceptions addressing specific populations, this proposal would narrow the application of the student rule just to temporarily low-income students living in dormitories, the population as originally intended, simplifying program administration. This proposal would also address the conflicting student definitions and requirements between affordable housing programs.

10. **Repeal QCT basis boost population cap**

Under current law, a 130 percent basis boost is available for properties in qualified census tracts (QCTs) designated by the U.S. Department of Housing and Urban Development (HUD) with poverty rates at or above 25 percent or where 50 percent or more of the households in the census tract have median incomes at or below 60 percent of AMI. This QCT designation, however, is subject to a cap if the aggregate population of the census tracts exceeds 20 percent of the metropolitan area population. This proposal would remove the aggregate population cap, enabling properties in more areas within the metropolitan region to receive the 130 percent basis boost, and likely making more Rental Assistance Demonstration (RAD) and other preservation developments financially feasible because they would qualify for the boost.

We are excited about the positive impact that the LIHTC is having on the nation's low-income communities and low-income persons, and its potential for future success. The furtherance of the LIHTC will better provide affordable housing and help increase the number of jobs in our communities. We appreciate the opportunity to submit our comments to explain the importance of retaining the LIHTC as part of the tax code, and we thank you in advance for your time and consideration. Please do not hesitate to contact us 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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